

# Chapter 1

## A World on Edge

**A**s the world passes through the second decade of the twenty-first century, we find ourselves in the midst of a global financial crisis that threatens the way of life of virtually the entire civilized world. From the United States to Europe, Russia, Eastern Europe, and Japan to South America, India, and the Middle East, and yes, even to China itself, most of the world's 7 billion people face a global economic crisis—perhaps even a global depression—that appears to have no rational ending in sight.

I say *rational* because the current course being pursued by the world's central banks shows no real potential for solving the crisis of debt and economic contraction that every major developed economy faces today. The policy of *quantitative easing* that every major economy, including China, is following—though temporarily helpful to some segments of the economy like the banks, stock markets, and corporate coffers—ultimately only adds more debt to an already debt-choked international financial system that sees productivity falling and is based upon a currency, the U.S. dollar, which itself is rapidly fading in value if not validity.

Consequently, the world finds itself at a crossroads. The current-but-broken international financial system, founded upon the vitality of the U.S. economy and a gold-backed U.S. dollar and held together by the imposition and enforcement of a set of rules by U.S. economic and military dominance, no longer works as it once did. The last pretensions of a gold-backed dollar disappeared in 1971 and the U.S. national debt and deficit spending have both been on a constant increase since then and are well beyond the point of anyone believing that such debts will ever be paid back. The global financial crisis at hand is perhaps the final symptom of this dysfunctional system before it crashes altogether. This now inadequate system, like an aging man, is full of frailties and weaknesses and is but a shadow of its former self, with a sclerotic capital system that is unsustainable and clogged with so much aggregation of debt that it can no longer be supported by falling productivity or the spent energies of 50 years of debt-fueled consumption.

One of the problems the world faces lies not just in where to go from here, but how to get there. At the same time, as the worst financial crisis the world has seen since the Great Depression continues to unfold (the 2008 credit crisis is neither solved nor cured, but is only being *managed* with massive amounts of new credit), military relationships and trade relations are being formed and re-imagined at this writing, which, to any careful student of history, ought to sound alarm bells loud, clear, and urgent.<sup>1</sup> The result of the last global financial crisis, the Great Depression, was the global conflict that became known as World War II. However, given our sophisticated and deadly technological age, large-scale and protracted warfare, particularly on the scale of a global conflict, is utterly irrational; and yet that is the direction in which much of the world seems to be headed in an unmistakable and disturbing hurry.

### **What Is the Proper Context in Which to Assess China Today?**

Viewing China through the prism of the current global financial crisis is tempting and facile; with over a trillion dollars in reserves and deep trading relationships with both the United States and the Eurozone, as well as with Russia and Japan, China seems to be the nation least vulnerable to the negative effects of the financial crisis. But the dynamic of the global financial crisis

is not the complete or only context in which to view China and its place and position in the world; as we'll see, it is truly not the most important either.

China's economic strength, whatever it is or may turn out to be, is a function of many factors, as are its military capabilities and diplomatic influence. Not least among those factors are the internal arrangements of China. By that, I mean the manner in which Chinese society is organized, the reliability and stability of its domestic economic and political structures, and how key economic and political decisions are made and carried out. Perhaps most crucial of all are the nature, history, and track record of just who makes the big decisions for China and why.

From that point of view, the global financial crisis is an external threat to China's economic viability, but so are the deep flaws and recurrent weaknesses in China's political economy that are being revealed in part by the financial crisis, and in part by China's exposure to the world as never before. The difference today is that China no longer exists in a state of autarky as it did for virtually the first three decades after the revolution. In fact, how China chose to engage in the global economy and arrange its economic footing—going forward from communism to a distorted form of state capitalism—is also a function of its Communist Party decision-making process and, as we shall see, is truly a fundamental and growing weakness in China's current economy.

Again, China certainly *seems* to be better positioned and more agile than either Europe or America in weathering the effects of the financial crisis. But is that really the case? How will China fare as the Eurozone slips into deeper levels of recession and Cyprus-style financial meltdown in 2013 and beyond?

There are essentially three schools of thought on how China will fare in the near future in the midst of the global economic crisis in which the world now finds itself. One view is that China will continue to weather the financial storm relatively well, given its level of economic development, the size of its internal market, its high level of liquid reserves, and other seemingly favorable facts and statistics on its economy. This may indeed prove to be the case, as those are certainly strong factors working in China's favor. Given that the Eurozone—the major economic trading bloc on the Eurasian continent—is on the edge of financial collapse, and that mass violence in the periphery nations of Greece, Portugal, Spain, and Italy threatens the legitimacy of governments and the stability of Europe itself, China, by comparison, looks to be in a much stronger position to weather the financial storm.

Is this true though? The crisis in the Eurozone has yet to reach its final stages, but China is looked to as the biggest source of market-rescuing capital for the Eurozone.<sup>2</sup> China, however, has yet to fulfill the role that some in the Eurozone fervently wish that it would. A very good question is, “Why haven’t they?”

Another view on China’s fortunes going forward (arguably less ideal, but perhaps more realistic than the first) is that China will continue to suffer some of the effects of the global financial downturn, but will prove to be flexible, agile, and smart enough to come through the next few years relatively well compared to Europe and the United States. This viewpoint toward China is still in the same orbit as the first view, but with a more or less bumpier ride built into the assumption. But still, it has China emerging from the crisis in a relatively more favorable position than it was in before the crisis.

Is this a realistic outcome for China? Is China, among the major economies of the world, truly best positioned to endure the financial crisis that threatens capital flows, investment, productivity, and consumption levels the world over? That is the implicit assumption underlying this viewpoint of China.

More precisely put are the facets of China’s economy—its manufacturing base, domestic market, and technology sector—deeply embedded, nimble, diverse, and innovative enough to react to and overcome the challenges to which other highly developed economies such as the Eurozone, Japan, and the United States are struggling to adapt? This is an even more difficult question to answer in the affirmative when one considers the past history of decision making by China’s leadership, its political culture, and its economic frailties that are now coming to the fore, and for which China has no immediate answer or cure.

This question, of course, leads us to a third view, one that is still shared by only a minority of observers. And yet, increasingly, it seems to be the most correct and likely view—that, in a nutshell, China is headed for another disastrous chapter in its history of disasters brought about by its communist leadership’s decision-making process and inherent incompetence.

Although it may sound like political ax grinding between capitalism and communism, it is not. Rather, it is an acknowledgment that China’s leadership has created an economic monster that is so distorted in its foundations and its execution as to render it incapable of reacting quickly enough or in the ways necessary to avoid a massive collapse of

the system altogether in the face of rising internal crises which threaten China as much as, if not more than the global financial crisis threatens the Eurozone or the United States.

That more pessimistic view is also shared herein. It is not a wish or a hope, but simply an assessment of the conditions within the Chinese economy, population, and various policies that appear to conspire in their aggregate to cause a reckoning of sorts, which will not only be quite difficult for China to overcome, but poses real doubts about whether or not the China we see today will be recognizable in the next few years. More than its distorted economy, however, it is China's distorted political system that will be the country's undoing. China's Communist Party leadership and the political culture surrounding it are posed to catalyze the latest version of calamity that the Party leadership has brought to China since it took power over six decades ago.

### **China's Historical Context**

A brief look into China's modern history provides useful insights into not only who drives China's policies, but also how and why they are driven as they are. It will also help illuminate the great flaws and resultant weaknesses and failures of modern China's financial and economic system and of its political culture, as well as the great and terrible implications and causations that it imposes not only on the Chinese people, but also on the very land and natural environs of the part of the planet that China inhabits.

Historical context is a wise place to begin to understand China, because nations, like people, are shaped by their pasts and their world-views are influenced by what they have experienced. Understanding the past of a country can therefore help us in understanding, at least to some degree, its view of itself and of the outside world. That context, in turn, can help us to understand China's worldview, its perception of the current U.S.-dominated financial system, and how they view their role in the world going forward.

A full and in-depth history of China is beyond the scope of this book. However, a brief look at some salient points of China's experience in the twentieth century, leading up to and including the communist revolution and the main crises that followed the revolution, is helpful in understanding the major thrusts of China's experience as a nation in the twenty-first century. The discussion that follows, therefore, is useful in

providing a context for viewing some of the more impactful of China's recent historical influences, but it is by no means intended as an exhaustive account.

## China's Place in the World

Throughout antiquity, China's name for itself was the "Middle Kingdom" because it was located in what they considered to be the middle of the known world. There has been, however, no shortage of cultural perception throughout China's history that allowed it to regard itself as the most important country, and most advanced culture, in the world. This was true for centuries. Those nations and cultures outside the Middle Kingdom were, by definition, inferior and viewed as barbaric, lesser peoples from whom nothing useful could be learned. This was true for a time. But such a combination of conceit and insularity did not help China in developing itself beyond the agrarian stage, while Western European nations began to rapidly industrialize from the seventeenth century onward.

About 100 years ago, in 1912, the Republic of China was founded, ending over 2,000 years of imperial dynastic rule. The last of the dynasties, the Qing Dynasty, which was also known as the Manchu Dynasty, ruled China from 1644 to 1912. The republican government that was established in its place was far from stable or effective, but events within China and outside it hardly gave it a chance to succeed. By the early twentieth century, feuding warlords, divided interests, and meddling foreign powers repeatedly beset the Republic of China. Continuous sources of internal strife such as shifting allegiances and political missteps, as well as external influences such as the invasion of Manchuria by Japan all contributed to an ineffective leadership of China during this time.

In 1928, there was a loose unification in China under the Chinese Nationalist Party, also known as the *Kuomintang*, but this did not last, as rifts developed between it, the Chinese Communist Party, and competing warlords. This made industrialization and modernization progress, which China was striving to achieve, more difficult; it came to a halt altogether once the Japanese invaded China in 1936. From that time until 1945, China was involved in a war of resistance against Japanese aggression and occupation as the Japanese sought natural resources and territory for its imperial expansion plans.

At the end of the Second World War in 1945, with the Japanese driven out of China, the civil war between the Nationalist forces and the Chinese Communist Party forces resumed in full force for the next four years. Economic development plans were again delayed by that internal conflict, which involved more death and destruction. Thus, the Republic was only to last 37 years, when, in 1949, the Republic of China was defeated by the Communists in a drawn out and very bloody civil war. Sadly, the level of slaughter at the hands of the Communists under the leadership of Mao Zedong was unparalleled in all of human history, as 50 million or more Chinese were killed due to war and the resulting mass starvation.

Having lost the war to the Communists, the Nationalists fled the mainland for Taiwan, where they set up a one-party authoritarian regime with martial law, just as the Communists set up a one-party dictatorial regime on the mainland. The comparison between the two Chinas is an apt and useful one because both Chinas began as rigid political regimes with minimal liberties and effective marshal law in place. However, the Taiwan regime eventually liberalized its society beginning in the late 1970s, and actively adapted to the global economy and diversified its economy. It pursued more advanced economic activity and development as it adopted a market-based capitalist model for its economy. By 1986, Taiwan's Republic of China had reformed itself into a multi-party representative democracy with a rapidly rising standard of living.<sup>3</sup>

## China's Self-Inflicted Crises

Meanwhile, from 1949 onward, Communist China, also known as the People's Republic of China (PRC), languished in underdevelopment hell. The country and its people experienced enormous tragedies borne of the unbelievably damaging and misguided economic and development policies made exclusively by the Chinese Communist Party leadership. The policies were the product of a combination of political paranoia, ideological zealotry, and utter stupidity and ignorance of the laws of supply and demand, coupled with an institutionalized culture of corruption and deceit that continues in China to this day.

Understanding how and why these self-inflicted crises came about in China is crucial because it reveals a recurrent pattern in decision making as well as those fatal political flaws that remain in their political and economic system today. They also explain why China will face similar crises of massive proportions in the near future. With their victory in 1949, Communist China's Mao Zedong began a vigorous purge of dissidents, the educated, and the landowners to eliminate enemies of the new Marxist state. After several years of consolidating power, Chairman Mao and the Communist Party put Leninist-based economic development plans in force. The first of these was called "The Great Leap Forward" and was put into action in 1957.

## Great Leap Forward or Famine?

The Great Leap Forward was the first effort by the Communist leadership to reinvent China from a largely agrarian society to an industrialized one. The goal was to gain industrial parity with Great Britain in 15 years. Then, after only one year, that goal was, incredibly, changed to only a one-year timetable. That was just the beginning of the madness.

Immense social and agrarian dislocations occurred as forced communal farming was introduced by the Chinese leadership, and productive farmers were retargeted to produce steel in backyard furnaces, which proved to be a complete failure, producing low-grade metal virtually unusable in any industry. Meanwhile, more landowners and farmers who resisted the theft of their land or otherwise did not go along with Mao's vision were executed. Over 500,000 farmers, landowners, and dissidents were killed by 1958<sup>4</sup> and over 100 million people were forced into labor for massive industrial projects.

Facing such unrealistic industrialization goals, production numbers were inflated in all strata of the economy and the cadres, including food production objectives, in order to avoid punishment by the Party. Consequently, what was mistakenly thought to be surplus food was exported from China, leaving tens of millions of people to starve to death, while many others were beaten and killed by roaming bandits in search of food. Thus, by simple decree, without logic or informed reasoning, the very fabric of Chinese life was rent and put under enormous duress with

tragic and catastrophic results. As Dali Yang points out in a *University of Chicago Chronicle* piece from March 14, 1996:

No one is sure exactly how many people perished as a result of the spreading hunger. By comparing the number of deaths that could be expected under normal conditions with the number that occurred during the period of the Great Leap famine, scholars have estimated that somewhere between 16.5 million and 40 million people died before the experiment came to an end in 1961, making the Great Leap famine the largest in world history. People abandoned their homes in search of food. Families suffered immensely, and reports of that suffering reached the members of the army, whose homes were primarily in rural areas. As soldiers received letters describing the suffering and the deaths, it became harder for leaders to maintain ideological discipline. Chaos developed in the countryside as rural militias became predatory, seizing grain, beating people and raping women.<sup>5</sup>

The lessons to be learned here are not from the failures of the Great Leap Forward, although they are many and deserve to be remembered and condemned. No, the real lesson to understand is the absolutism of the Communist Party leadership and absolute failure of the Communist Party leadership to lead the country properly, as well as their failure to make wise and prudent decisions, and their complete willingness to let tens of millions of their fellow Chinese die horrible deaths in their quest to hold onto power.

Yang also notes in his book, *Calamity and Reform in China*, “Historical developments during more than four decades of Communist rule in China have again and again shown us how the unanticipated consequences of elite policies subverted their attempts at fundamental social engineering.”<sup>6</sup>

He further warns of “the crucial importance of guarding against those who claim to know some magic route to the radiant future, be they politicians like Mao or party intellectuals who supported Mao or the new technocrats who claim to have found a scientific way to make China rich and powerful and who happily clamor for more power for themselves.”<sup>7</sup> That idea of special knowledge has been and remains the vision that is sold to the people by the CCP to this very day; as we will see, that vision is much more of a recurring nightmare in China.

## Cultural Revolution or Social Cannibalism?

As with the Great Leap Forward before it, a similar result was the outcome of China's *Cultural Revolution*, again, spawned by Chairman Mao and the Communist leadership in 1966 and continued up until 1976. In this 10-year reign of hell on Earth in China, no one is sure just how many people were killed, but the numbers are again horrific. China was once more torn apart as Mao sought such disruption as a means of maintaining power against various political challengers, including the Chinese Army itself.

For an entire decade, the educated, the able, the productive, and the wise were sought out, humiliated, excoriated, imprisoned, sent to re-education camps, and, of course, executed. Schools were also closed for the entire 10 years, leaving a whole generation uneducated.

The political reasons for the Cultural Revolution, its objectives as well as its manifestation in China, are almost unbelievable in their scope, destruction, cruelty, and stupidity. For instance, for what possible reason would the leaders of China stop all education for a *whole decade*? Were they mad?

A description of the Cultural Revolution, from the website *Encyclopedia of Marxism*, is helpful in getting one's mind around such an epic, inhumane, and mind-numbing event:

The "Cultural Revolution" was aimed at smashing the Chinese Communist Party, and rebuilding an administration owing allegiance to Mao alone. . . .

In the first phase of the Cultural Revolution, the urban youth were mobilised against the intelligentsia and better-off or educated sections of the working class. To this end, Mao . . . taught the youth to regard all manifestations of culture as bourgeois and counter-revolutionary. Lessons were stopped, all entertainment and social life other than "politics" denounced, and "politics" reduced to mindless repetition of "Mao's Thoughts" and the witch-hunting of anyone unwilling or unable to reduce themselves to the same idiotic level.

In the second phase, the atomised and terrorised population was mobilised against the Party. Mao declared that the "bourgeois headquarters" was in the top leadership of the Party itself, and

called on the population itself to overthrow the Party administration in their area. . . . Mao had no mechanism for controlling or directing the “revolution.” In all areas of the country, rival groups claimed the mantle, and launched holy war, not only against the “capitalist-roaders”—generally the best elements of the Party—but against each other. China degenerated into the chaos of factional fighting. . . .

Torture and murder were carried out quite publicly, by the public, and were supplemented by very effective social control through the eyes and ears of a thousand million neighbours, friends and family members.

In the third phase, Mao had brought the country to the brink of destruction. Some way had to be found to halt the disintegration. To this end, the urban youth which were out of control in the cities were broken up into small groups and sent to the countryside to “learn from the peasants.” Just at a time when Soviet scientists were beginning to catch up for lost decades. . . . Peasants lectured agricultural scientists instead of the other way round.<sup>8</sup>

The Cultural Revolution ended only with the death of Mao in 1976. But again, the people’s “own” government, run by the Communist Party, perpetrated a terrible reign of terror over and against them for purely political purposes. The Chinese government estimated that around *30 million people died* from political executions at the hands of roving armed cultural Red Guards, who killed anyone who demonstrated bourgeois tendencies (which meant virtually anyone who was productive), as well as by starvation or suicide.

Again, the lesson here is that mistakes are made on a grand scale in China by a leadership structure and ideology that pits the Communist Party and the state against the people, without having to answer to the people. China’s huge population not only makes human life expendable on a mass scale, but it also requires, so it is apparently believed, a heavy authoritarian state to rule them. (Note that China’s neighbor, India, with 1.2 billion people, is the world’s largest democracy.) This is particularly the case when the policies that the leadership imposes upon its people are not popular and cause millions upon millions of them to die.

Social engineering, as it were, and many of the political and economic policies deriving from it, became no more than a way to control the masses in China by setting them against themselves, rather than having them rise up against the leadership. It is repeatedly evident that the overriding goal is not just economic improvements to the nation, but for the Party to hold onto power at any and every cost.

The clear lesson here is that the “mistakes” of both the Great Leap Forward and the Cultural Revolution were part and parcel the result of not just the personality cult of Mao Zedong, but of the *personality* of the communist leadership structure of China. Long after Mao’s death, the Communist leadership of China continued to make boneheaded economic moves and oppressive crackdowns on political dissidents, students, businessmen, artists, and writers—anyone who threatened the existing power structure by pointing out the obvious illegitimacy of their ruling position and their idiotic and destructive policies.

That is not to say that the Chinese Communist Party has cornered the market on mass executions, misguided economic policies that decimate the nation’s food supply and leave millions to starve to death, persecution of political enemies, and an overriding drive to dominate all aspects of life for its citizens. No, that is the *personality* or intellectual framework of all communist regimes, a particularly toxic political ideology that bloomed in full flower ever so deadly in the twentieth century. Indeed, Lenin and Stalin in China’s neighbor to the north, the Soviet Union, had shown the way 20 years before, and the regimes of Cuba and North Korea, both desperately poor and brutal societies, joined China as the remaining troika of their kind to survive into the twenty-first century.

The last public demonstration of the Chinese Communist Party’s deliberate heavy-handedness was in Tiananmen Square in 1989, when thousands of students demonstrated against the leadership in China and for democracy, and were, after several weeks of global publicity, overwhelmed and killed by the Chinese army that included tanks and heavy caliber machine guns against unarmed youth. Think things have changed today? Many of the new leaders in power today were CCP underlings at the time, and, as we shall see later in this discussion, demonstrations and

massacres in China are, to borrow a phrase, “like street cars. If you miss one, don’t worry; another will be along shortly.”

The abysmal fact is that China struggled for the first 30 years after the revolution to modernize with great and yet unsuccessful efforts at tremendous human costs. After several attempts to develop itself through various harebrained ideas culled from the pages of Marx and Lenin’s proscriptions for development and Mao’s own misguided musings (which all led to tragically inefficient collectivist farms and mass relocations of its populace to horrendous bouts of re-education, fruitless backyard iron ore furnaces, political purges, and tens of millions of deaths), the Chinese leadership concluded that they had to change tactics. This led directly to the opening of the Chinese labor market to American multinational corporations, which would soon become a deep trading relationship, swapping cheap Chinese labor for some of the highest levels of U.S. technological know-how.

The result? In a few short years, as the United States and other Western nations engaged in business with China, Chinese development took off at an astonishing rate. Private ownership of businesses was allowed and expanded by the post-Mao era Chinese leadership. It is key to understand that this cooperation with the United States and other Western nations was as much in order for China to develop as it was for the Chinese leadership to maintain its mantle of legitimacy.

To that end, Deng Xiaoping made the observation in 1978 that China must develop, or face being dominated by the West once again. To put a very fine point on it, the Chinese leadership knew that they would face extinction either at the hands of the developed Western powers, or at the hands of their own people if they were not successful in modernizing the country. It was obvious to Deng that communism was not going to do it for them. It was then that the leader of the Chinese Communist Party observed, “What difference does it make if the cat is red or white as long as it catches mice?”

Not long after, in the mid-1980s, the Soviet Union was already undertaking its own reform and restructuring efforts under Gorbachev’s *Glasnost* and *Perestroika* policies. This was a last ditch effort by Gorbachev to save his communist empire from crumbling due to its ineptitude and stagnation. Undoubtedly, the Chinese leadership could read the writing on the Berlin Wall.

But on the national level, to learn from the past invariably means to be able to change the way of behavior from the past. Such changes, in the case of China, involved a restructuring of its society in some areas—those exposed to the West—and importantly, allowing itself to partially, and ever so carefully, integrate itself with the global economy.

## How Has Economic Integration with the Global Economy Changed China?

Allowing itself to integrate with the global economy—and particularly with the United States—has, as noted, greatly affected the course of China's development. China has developed more rapidly and deeply in the past 25 years, albeit in a greatly imbalanced, unstable, and unjust fashion, than anyone could have foreseen. But at the same time, in addition to the blessings of development, there are also severe drawbacks that accompany the development path China has followed.

The greatest drawback is the threat that development in China, not only in fact but also in the means and methods of its development, poses huge risks for both the Chinese leadership and to the Chinese people.

What do I mean by that?

Simply that China's development path has led to a variety of social, economic, and political consequences, which pose direct challenges to the elite communist leadership and life-threatening conditions for the people that are only now coming to the fore. We will look into the ways of viewing China's challenges that will not only show the dangers of China's development path, but also the political and economic dangers of its one-party Communist leadership.

Today, far from being the exotic, strange land that it once was, China is now in the very center of the vortex in world politics, international finance, and negotiations for global stability. As you might expect, there are today more places in the world where China plays an active and leading role than ever before. Like the United States for the past 65 years or so, China's presence and influence is now felt and acknowledged worldwide, from the financing of bridges in Indonesia, infrastructure in Africa, automobile manufacturing for Volkswagen and

General Motors, to the manufacture of Apple Technology's most innovative products.<sup>9</sup>

## Is China Becoming the Next Superpower?

Today, many leaders, strategists, academics, and political observers throughout the world view China as the next superpower. Indeed, the prevailing sentiment in that belief is that China is on the cusp of not only supplanting the United States as the global hegemonic power of the twenty-first century, but also, just as importantly, the United States is in its last throes as a superpower.

Are either or both of these true?

The fact is that the ability of the United States to influence events and outcomes throughout the world is declining both relatively and absolutely in the face of the increasingly powerful Asiatic colossus that China has become. The rise of China into a global economic and manufacturing powerhouse certainly appears to be true, and in many ways it undeniably *is* true. The nature and sources of China's ascension, however, need to be explored and understood before assigning China the title of emerging superpower.

This is especially relevant when considering that the United States has been to this day and remains the driving source of economic growth in China. This may be a controversial position to take, but it is nonetheless true. We will revisit this assertion in the pages to come, but it bears keeping in mind as we review key aspects of China's power in the world and the prospects for its continued growth and, more to the point, its continued existence.

It is no stretch of the facts to point out that compared to other nations like Russia or India, or even supranational entities like the Eurozone, China's power and influence in the world is not only growing the most rapidly of all of them, but it is also the most far reaching. China's rise is naturally, if mistakenly, compared to that of U.S. power, which, in all its facets, is certainly not what it once was relative to the rest of the world in general and to China in particular. That is a common and misleading mistake in judgment, which leads to unfounded, and therefore inaccurate, conclusions about China's present and future state. Taking a brief look at where China is today is helpful in putting the depth and scope of China's rise in the proper context.

## Trading Partner to the World

China is the Eurozone's largest trading partner, and together they are two of the biggest traders in the world, with annual trade between the two exceeding \$365 billion per year.<sup>10</sup> The rise in trading relations has been steep and deep, meaning that not only has the value of the relationship grown exponentially, but also the interdependent nature of the trade augurs for a long-term and economically symbiotic relationship between China and the Eurozone. Of course, the depth of trade relations between China and the United States should surprise no one. The United States is China's largest market, with an annual trade of \$202 billion and its annual trade deficit with China has increased 18 percent since 2008 to \$503 billion.

China is the second largest trading partner with the United States after Canada. United States trade with China in 2011 totaled about \$400 billion, with the United States running a trade deficit of \$295 billion.<sup>11</sup> To say that the economies of China and the United States are codependent upon one another is to state the obvious. The economies have been integrated with one another on a scale that is without precedent for both countries.

The codependency between the United States and China can hardly be overstated. China is the largest foreign holder of U.S. Treasury notes, with about \$1.3 trillion, which makes it the biggest lender to the United States outside of the Federal Reserve, which only recently (2010) surpassed China as the United States' largest source of capital.

There is little doubt that China's purchase of U.S. debt is what supports the U.S. economy. And on the flip side of that, there is little doubt that the United States' vast consumer market sustains China's vast manufacturing base, which relies heavily upon exporting low-cost consumer products to the U.S. market for its very survival. Without access to U.S. markets, China's rise could never have occurred. And without access to China's capital, the U.S. economy would come to a halt almost immediately.

How deeply integrated has China become with the U.S. economy? In 2012, China was given unprecedented access to the U.S. financial system in several ways that were simply unthinkable just a few short years ago. For instance, China has been given direct access to the U.S. Treasury to buy—and presumably to *not* buy—U.S. Treasuries without the rest of

the U.S. bond market having any idea of China's dealings with the U.S. Treasury. Also, for the first time ever, Chinese banks are being allowed to own and operate banks in the United States.

## The World's Manufacturer

China has become the world's manufacturer, as thousands of firms from the United States and Europe have relocated their factories to China in the past three decades. Of course, China's rise in manufacturing was no accident; its extremely low labor cost coupled with the allure of over 1 billion people to sell to has proven to be irresistible to major and minor manufacturing firms from around the world. This has resulted in the oft-used phrase *hollowed out* to describe a nation's economy when its manufacturing base has been shut down and left the country for more favorable labor and materials costs overseas. Ironically—or perhaps not so much—the Chinese market has largely been kept at arm's length from most Western firms.<sup>12</sup>

Still, as firms built more and more of their products in China, the result has been that fewer and fewer products are made in the United States and Europe, two of the largest industrialized regions on earth. In the face of an aging population and social welfare states under immense financial stress, both Europe and the United States, and also Japan for that matter, found themselves unable to compete with China's lower labor costs. The lack of unions and plentiful workers at slave labor wage rates has given China a great advantage that they have made every effort to maximize.

The unparalleled expansion of China's rise as a global leader in manufacturing is significant because manufacturing is the base of a healthy economy, which, in turn, is the basis for a healthy currency. Furthermore, economic statistics are announced regularly that repeatedly make the case that China will replace the United States as the world's next superpower, such as news reports that China surpassed the United States as the world's number one trading nation in early 2013.

Does this validate the assessment of China as a rising superpower? It certainly is an outwardly positive statistic, but it does not tell the whole story, nor does it necessarily mean all is well with China's economy.

Is China really that productive? And what is the quality of that productivity? A look at the demand for commodities is a key indicator of China's—or any country's—level of productivity.

## An Appetite for Commodities

As a manufacturing powerhouse, China has become the largest consumer of commodities in the world. This includes iron, nickel, copper, gold, silver, and numerous other manufacturing, energy, and food commodities. China's GDP growth rate has averaged 8 percent or more for the past 20 years,<sup>13</sup> thanks to the rapid transformation of China from a backward agrarian nation to a global manufacturing giant. Its economy has risen from the eleventh largest economy in the world 20 years ago to the second largest, behind only that of the United States.

Because China is one of the world's largest consumers of commodities, it is also one of world's greatest influences on the prices of commodities. This means that China is a market maker in commodities and therefore has terrific influence upon the economies of the world that are commodity based, like Australia, Chile, and others. Likewise, a drop in China's consumption of commodities is an indicator of a slowdown in demand in China. However, a decrease in China exporting a commodity may be a trade indicator of a different sort. Take rare earth elements, for example.

China's restriction and near monopoly of rare earth elements to the world market is a strong indicator of the CCP's adversarial view of trade. China was admitted to the World Trade Organization (WTO) in 2001. One of the criteria was for China to loosen their export restriction on rare earth minerals, which account for 90 percent of world exports. China's refusal to do so 10 years afterward, even after WTO ruling that it must do so, exhibits its adversarial trading habits that spill over into many areas of China's economic policies and activities. This attitude is in direct contrast to those of its U.S. and European trading partners. This is a policy decision made at the highest levels of Chinese leadership and indicates that the paranoid nature of the Party remains intact, as it always has.

Later in this discussion, we further explore the meaning and impact of China's great appetite for commodities. But for now, let us simply

acknowledge that, whatever it may or may not do, China has become a major player in the global economy.

## Why Does China Have “Gold Fever”?

China is not only the world’s largest producer of gold, mining over 340 tons in 2010 (8.57 percent over the prior year’s level), but it is also one of the world’s largest consumers of it. In 2010, People’s Bank of China (PBOC) bought over 209 metric tons gold, a 500 percent increase year-over-year. In 2011, PBOC’s purchase of gold increased to 490 tons and Chinese mining output exceeded 360 tons, a 6 percent rise over 2010. In 2012, Bloomberg estimated that China purchased an additional 493 tons of gold. China will also seek to further increase its total gold production. There is much speculation as to why the PBOC is purchasing massive amounts of gold. Some view their growing gold reserves as a hedge against falling values of other assets, perhaps even against its own massive U.S. T-bill portfolio.

Tim Iacono wrote about China’s gold fever, citing the *Financial Times* interview with Marcus Grubb of the World Gold Council (WGC):

China central bank gold buying is believed to have played a major role in the surge in China’s (2011) fourth quarter imports:

China’s imports from Hong Kong, which account for the majority of its overseas buying, soared to 227 tonnes in the last three months of 2011, according to data published by Hong Kong. Mine production in the country, the largest gold producer, stood at about 100 tonnes in the quarter, implying total supply of at least 330 tonnes.

That compares to demand of 191 tonnes for gold jewellery, bars and coins—which account for the vast majority of Chinese demand—reported by the WGC on Thursday.

Since China does not allow the export of gold, there was a domestic supply/demand gap of about 139 tonnes during the last three months of the year and central bank purchases likely accounted for some or all of that gap. This is consistent with the widely held belief that China’s central bank will continue to quietly accumulate gold, buying on price dips such as the one

in December and only revealing to the world the extent of their purchases long after the fact as they did back in 2009 when they said they had nearly doubled their gold reserves to 1,054 tonnes since it last reported its official holdings six years earlier.<sup>14</sup>

There is also the possibility of China eventually backing their currency, the yuan, with gold in order to make the yuan a competing currency against the dollar.<sup>15</sup> This would not only give the Chinese people greater spending power, but relative to the dollar, would also make U.S. goods more affordable to the Chinese. Whether commensurate amounts of U.S. goods ever get to the Chinese marketplace, however, is a dubious possibility, to say the least.

Today, the world's reserve currency, the U.S. dollar, is backed only by a promise to pay issued by a government that is financed on debt, runs huge trade deficits, and whose current economic growth rate makes it clear that for the foreseeable future, it will not possibly be able to repay its debts without inflating its currency at some point in the future. Is there any doubt that a currency issued by the world's second largest economy and backed by gold would challenge or even replace the dollar as the world's reserve currency?

That may be the case, as is posited in the October 1, 2012, edition of *Forbes*: "China is preparing for a world beyond the inconvertible paper dollar, a world in which the renminbi [yuan], buttressed by gold, becomes the dominant reserve currency."<sup>16</sup> Such an outcome jibes with China's desires to challenge the United States' global financial dominance in the world today.

But there may also be a different, less obvious reason. It may be that the current strength of the Chinese economy is not what the world thinks it is. If that is the reality, and I think that it is, then the gold spree may be just as much of a hedge against their own economy and currency as it may be against their U.S. Treasury bond holdings. Does that mean that the Chinese will not challenge the U.S. dollar-denominated financial system? It's unlikely, but doesn't automatically mean that the Chinese economy or currency will be able to replace that of the United States.

Getting accurate information about exactly who in China is buying what amount of gold is a difficult proposition in any case, as the PBOC

doesn't release information or its plans. But the PBOC is not the only buyer of gold in China. As Gordon Chang notes in his January 29, 2012, article in *Forbes*, much of China's gold purchases may be from individual Chinese who are skeptical of China's economy and currency. Chang notes that the Chinese themselves may well have insights into the Chinese economic conditions that outsiders do not, and since the Chinese are not allowed to export gold, buying gold is their only hedge against an already overvalued yuan.<sup>17</sup>

## What Does the Rise of Other Nations, but Especially of China, Mean for the Current Financial System?

The rise of competing nations will continue to bring competition and strife to the international dollar-denominated financial system. I say *continue* because the strife among the trading nations, amongst both allies and adversaries of the United States, has been ongoing and increasing as the global slowdown worsens. As the global economy continues its long, debt-laden decline, nations will use whatever leverage they possess to their full advantage, and that relates directly to the balance of power between the United States and China.

With the United States purposely devaluing the dollar by injecting trillions into the world economy through various stimulus programs and other funding mechanisms, the price of commodities has risen for other nations who must buy commodities in dollars on the world market. By doing so, the United States is, in effect, making U.S. goods and services more competitive by exporting inflation to the rest of the world, including China.

The very fact that major commodities in the world are priced in U.S. dollars has meant that the dollar has been guaranteed a certain level of strength and demand in the world simply because nations must have them to buy and trade in the world. Whatever country you may care to name, if it wants to trade on the world market, in the vast majority of cases, it will have to have dollars to complete the transaction.

Even with China's rise, today, roughly 80 percent of all trading transactions in the world are still priced and transacted in U.S. dollars. China is taking major steps to change that reality, and has overtly implemented some challenges to the United States' *dollar hegemony* that it still enjoys throughout the world. For example, it has entered into direct exchange and trade

agreements with Japan, Russia, and South Korea to trade their respective currencies directly without using the dollar as an intermediary step. *Dollar exclusion zones* in Brazil, Chile, and other nations have also been established by China. It may seem that that is a direct challenge to the U.S. dollar, but the degree of the relationships is still comparatively small. There is the real possibility, of course, that it may change dramatically in the future.

Will the dollar's power diminish in the world as China's influence and power grows?

The dollar's role in the world may well diminish more in the very near future. But the possibility also exists that, as conditions in the Euro-zone continue to deteriorate, the dollar's role as important in the world may grow dramatically, or it may diminish entirely. This would especially be likely if China's current trajectory is altered, which, I argue within these pages, is quite likely to become a reality.

## Marketing the China Brand

China's cultural footprint is also growing in the world. There are now over 60 Chinese cultural centers located on university campuses across the United States alone. And, as *World Affairs* reports, there are now

two hundred and eighty-two Confucius Institutes scattered around the globe, all controlled from Beijing by the Office of Chinese Language Council International. China also has its own version of the Peace Corps, run by the China Young Volunteers Association, which sends young Chinese to do development work in countries with friendly governments, like Laos, Ethiopia, and Myanmar.<sup>18</sup>

Additionally, China is making a great effort to not only get its culture into the mainstream of ideas in the global culture, but it is also seeking to control its image, or brand if you will. This is especially true in the cinematic arts, which are the most efficient in reaching large, supranational audiences.

For example, the 2012 purchase of AMC Theaters, the largest theater chain in the United States, was a strategic purchase, just as financing and

promoting films like *Crouching Tiger, Hidden Dragon*, which won Academy Awards and was seen and lauded around the world by hundreds of millions of people, was also a deliberate tactic to “sell” China—and most importantly, the “correct” China—to the world. Additionally, China’s official “global media drive,” a \$7 billion project that began in 2009, is a deliberate policy designed to change the world’s mind about China and culturally challenge the *American Idea* in the world.

China’s shadow on the world stage grows larger every day, whether it is its unprecedented direct access to buy and sell Treasury Bonds from the U.S. Treasury itself, to its massive investments in farmland across Africa and North America, to its possible role in providing much needed financial liquidity to a Eurozone that stands on the edge of total economic and currency collapse at this writing. China understands that the various channels of power must include *soft power* like cultural affinity, good will, foreign aid, and the like, and has shaped its policies accordingly:

According to Rumi Aoyama, Chinese public diplomacy has five components: “Publicizing China’s assertions to the outside world, forming a desirable image of the state, issuing rebuttals to distorted overseas reports about China, improving the international environment surrounding China, and exerting influence on the policy decisions of foreign countries.” This simple set of priorities has an admirable clarity that entirely eludes comparable efforts by the United States.<sup>19</sup>

Indeed, the Eurozone is already falling into a deep recession brought on by the debt crisis that originated in Greece. The crisis has since spread to Italy, Portugal, and Spain, and it threatens France. Eurozone officials continue to struggle with how to save the euro as a viable currency and the Eurozone as a relevant political and economic player on the world stage. Unfortunately, to date, the financial resources of the Eurozone have proven to be insufficient. In their hour of desperation, Eurozone leaders have called upon China to help out with its trillion-plus dollars of liquid reserves. Whether China does so or not is almost irrelevant; the point is that as the world’s second largest economy and a perceived rising superpower, it is thought to be in a position to do so.

There are many other statistics and categories to illustrate the points already made herein—that China’s rise to global prominence is real and has had great impact upon the rest of the world. However, when comparing one nation’s historical path with another’s—such as China assuming the mantle currently on the shoulders of the United States—clarity and objectivity are important, lest one see too much, or too little, in comparing the two.

That said, context, of course, is important when seeking to understand the meaning of events, to comprehend the dynamics of changing relationships, as well as to grasp the full and long-term impact of those changes. Context, in fact, is everything when seeking to understand such concepts as polymorphous and often ephemeral as the balance of power among nations and the sources of power within nations. Thus, context is also a necessity for the various definitions and advantages, real or imagined, of a country’s national identity.

Be that as it may, the question, “Which context is the correct one?” begs an answer. In fact, at this time, it is virtually impossible to overstate China’s *perceived* financial clout in the world. China’s significance is undeniable, and its unavoidable influence around the world is in almost every field imaginable. But whether the decline in U.S. hegemony is fast or slow, and whether it will result in the fall of the international financial order dominated by the U.S. dollar are both fascinating possibilities in their own right; in this book, though, we focus our attention on the prospect of China’s rise in the world and determine if it is indeed poised to be the next great power on the face of the earth.

## Does China Have a Bright and Powerful Future?

Given all of these impressive facts about the speed and breadth of China’s rise to preeminence in the world, how can anyone conclude anything other than that a bright and powerful future awaits? How could all of the accomplishments and formidable signatures of a rising great power that are indeed a part of the picture of China be anything other than positive for the Middle Kingdom?

For one thing, as just noted, those things are a part of the picture, but not the whole picture of China. The description given is the picture

that the Chinese leadership promotes and wants the world to see and to believe. And, in the vast majority of instances, we dutifully do so. Just as there is no denying that China's story the past two decades is truly nothing short of stunning, there is also no denying that desperate people in need of financial rescue and new markets tend to not look closely enough at the gift horse that China represents in the minds of so many.

But once we admit that this is the case, it becomes clear that we need to look deeper into the phenomenon that is China to get a more detailed and accurate picture. When we do, what we will find is a portrait of a deeply flawed and riven nation whose many weaknesses are not yet acknowledged by the rest of the world and that are certainly not advertised by the Chinese themselves. Like the Great Wall of China itself (which, ironically, is both the most apt metaphor as well as the most powerful symbol of modern China, as it was of medieval China), much that is not so evident on the perimeter of our understanding of China becomes more visible when we look behind that Wall.

And what is there to see behind that wall that much of the world does not yet see or perhaps just chooses to ignore? As we take a close and careful look, we will see that things are not completely as they seem to be. China's many weaknesses—some of which are of such enormity that they are scarcely believable—become more apparent as we cast our view ever deeper behind the Wall and see what has happened on the inside of modern—that is, Communist—China in the past 60 years and in the past six months. There is much to see that has not been recognized for what it is, and even more to understand. We will identify the key elemental weakness therein and put their meanings in the proper context.

## **What's Really behind the Great Wall?**

What some see in China is not the next great superpower, but rather the next great collapse of a massively complex and brittle regime that is among the most brutal and oppressive the world has ever known. There is no crystal ball that tells us what will happen in the future, but there is known history in China, and China's modern history is one of great

crises and spasms of social and political violence on a scale unknown anywhere else, with the possible exception of the old Soviet Union.

There is, of course, the history and historical collapse of their former communist neighbor, the former Soviet Union; that in itself is not a definitive indicator, but it can certainly suggest possible outcomes. After all, command economies, wherever they are tried, all suffer from similar fundamental flaws that have all resulted in cataclysmic disasters.

But it won't be just one crisis that China will have to handle; it will be many, and all at the same time or in quick succession. There will definitely be a domino effect in play as the crises overlap and magnify the impacts of the others. Before too long, hundreds of billions, if not trillions, of dollars will be lost in China—and in Chinese companies around the world.

We will assess China under the following criteria that apply to any nation. The contexts in which we examine the questions will include:

1. Stability. Does China have a history of stability or instability?
  - a. Does modern/Communist China have a stable history?
  - b. Is China's current development path a stable one?
  - c. Does China's political system address instability, or does it cause instability?
2. Sustainability. Is the political structure and economic system sustainable?
  - a. Is political corruption and deception in Chinese society the exception or the rule?
  - b. Is the *Beijing Model* a sustainable model? Or is it an exhaustible model based upon external markets and false demand driven by unsustainable debt?
  - c. Is the development model sustainable? Is the majority of Chinese society improved? Or is most of Chinese society—or too much of it—abused by the development model?
  - d. Are resources used wisely? Are they extracted in the least environmentally damaging way possible?
3. Dynamism. Is there a healthy dynamic between society, the means of production, and the political system? Or is state capitalism absorbing and confiscating private capitalism, and physical and intellectual capital for political and financial advantage?

4. **Justice.** Is the political system based upon privilege? Is there legal redress for crimes committed by the government and state-owned enterprises against individuals and domestic and foreign business corporations? Or are massive land seizures, a caste system, and forced relocations of millions of people working for slave wages undermining legitimacy in the regime?
5. **Political Adaptation.** Is the political culture adaptive to challenges in society? Is the political culture an advantage to the business class in helping it adapt and overcome financial challenges? Or is the Chinese political culture one that increases oppression as wealth increases, and increases oppression as economic conditions deteriorate? Will State oppression, fraud, and illegal confiscation increase as economic hardship increases and State legitimacy diminishes?
6. **Creativity.** Does both the current economic system and political culture reward and encourage innovation? Is China a technologically innovative nation, or does it rely on theft and other forms of technology transfers? Do creative people stay in China, or leave? Is fraud-related creativity in terms of financial gain the highest form of creativity?
7. **Renewability.** Do the Chinese political and economic models allow for the Chinese economy to renew itself through innovation, creativity, and the free flowing and sharing of ideas and capital as economic conditions change? Is China's Beijing Model one that fosters renewability within China? Or are the massive levels of horrific pollution so great that renewability—including China's ability to feed itself—is symptomatic of China's Beijing Model, which is an exhaustive model sacrificing long-term stability and resource protection for short-term gains?

It will be from this framework that we will assess China's strength and possibilities going forward. And it will be through these lenses that we will take a closer look at China and its frail and brittle structure and identify just why—and perhaps even how and when—China will fall from within. We will also look at the potential ripple effects of China's coming collapse that will impact the rest of the world, but especially the United States, Europe, and the rest of Asia.

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