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### **U.S.-China ties: Chimerica – just a chimera?**

By Michael Richardson

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In his latest book, “The Ascent of Money”, historian Niall Ferguson describes the emergence of a new post-Cold War superstate. Called Chimerica, it is a fictional combination of China and the US. “For a time, it seemed like a marriage made in heaven,” he writes. “The East Chimericans did the saving, the West Chimericans did the spending.” The Easterners (in China) benefited from export-oriented economic growth and rising living standards, the Westerners (in America) from cheap imports and low inflation.

As part of ChiAsean, Southeast Asia has been selling raw materials, semi-processed goods and industrial components to the now fast-sloding Chinese economy. In return, Southeast Asia gained a major boost to domestic growth and increasing amounts of Chinese investment. It, too, has big stake in the health of Chimerica, since the US is a huge market both for China and for Asean.

Will the bond of mutual interest between the US, the world’s biggest economy, and China, the fourth largest, survive the global financial turmoil and deepening recession? A few weeks ago, David McCormick, US Treasury undersecretary for international affairs, said that Beijing had been “a responsible participant and ally” in dealing with the crisis. The Treasury Secretary Henry Paulson has been in Beijing this week (Thursday 4 and Friday 5 December) heading a cabinet-level team of US officials in talks with their Chinese counterparts on how to continue bilateral cooperation in these difficult times. But with President-elect Barack Obama due to take over next month, there is no assurance that the twice-yearly meeting of the US-China Strategic Economic Dialogue established by the Bush administration in 2006 will remain in place. During his presidential election campaign, Mr Obama accused China of keeping its currency artificially weak and using other unfair means to expand exports and damp imports.

At around the same time that Mr McCormick praised China, Russia’s pugnacious Prime Minister Vladimir Putin, who has repeatedly blamed US excesses and irresponsibility for unleashing the crisis, urged Beijing to jettison the dollar in favour of national currencies in bilateral trade.

The appeal appeared to leave his visiting Chinese counterpart, Wen Jiabao, unmoved. China's bilateral trade in goods with Russia was worth almost US\$43 billion in the first nine months of this year. It was dwarfed by the \$305 billion in trade that China did with the US in the same period. It was also dwarfed by the \$195 billion surplus in this trade that China piled up in the year to September.

Over the past couple of decades, China's accumulated trade surpluses, particularly with the US and Europe, have helped it amass the world's biggest foreign exchange reserves, around \$2 trillion – more than double the level held by Japan, which has the second largest holding. Some analysts calculate that China has invested between \$1 trillion and \$1.5 trillion of its reserves in US debt securities, including debt issued by the now government-controlled mortgage finance giants Fannie Mae and Freddie Mac. Indeed, it was significant that in the September bailout of these two distressed giants, the US Treasury was careful to ensure that bond-holders like China would not suffer – unlike the share-holders, many of them American regional banks.

China's prominent role as creditor to an increasingly heavily-indebted US was underlined by US Treasury figures released last month. They showed that in September, China overtook Japan to become the largest owner of Treasury bonds, bills and notes, with \$585 billion of these securities. The dollar has been strengthening against other major currencies, except the Japanese yen, in recent months as investors repatriated money to the US or sought refuge in dollar assets and cash. This has added lustre to China's dollar-denominated reserves.

Chinese credit in exchange for access to the US market: this is the unwritten compact between Beijing and Washington. China needs to keep exporting to earn foreign exchange, both to finance its trade and to support its currency. "As long as China wants to keep its exports to the US strong, it must recycle the trade surplus back into the US," says Michael Pettis, professor of finance at Peking University's Guanghua School of Management. "It is a symbiotic relationship that is unlikely to change anytime soon."

So mutually-dependent are the two economies that recent research by Citigroup found that if the US slowed by 1 per cent, China would brake by 1.3 per cent. Derek Scissors, a research fellow in Asia economic policy at the Heritage Foundation in Washington, casts this mutual dependence in even more dramatic terms. He agrees that America's increasingly lavish borrowing would be expensive without China's help. "Against that, our trade deficit with China was the equivalent of 6.5 per cent of China's gross domestic product through September. China is helping us try to avoid a 2 to 3 per cent decline in GDP in 2009 and 2010; we are enabling them to avoid a 6 to 7 per cent decline every year." China and the US, it seems, are like conjoined twins. They can only be separated by extremely complex surgery that may result in the death or severe disablement of one or both of them.

Chinese officials and analysts suggest that China will retain, and probably increase, its holding of US Treasury securities for the foreseeable future, provided it is confident America will recover from the credit crunch and recession. However, the crisis has prompted Beijing to rethink how best to manage China's reserves and run the economy in future.

Expanding domestic demand and reducing reliance on exports are likely to be hallmarks of any new regime. Shocked by the sudden storm of adversity, China will not want to be so heavily dependent for economic health on any one country again.

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