

China in the Global Financial Crisis: Rising Influence, Rising Challenges

The tsunami of financial chaos that engulfed the world in the first decade of this century has multiple causes stemming from a combination of Eastern liquidity and Western mismanagement. Inexpensive Chinese goods have kept U.S. and European inflation down, despite the U.S. Federal Reserve's highly stimulative monetary policy under Alan Greenspan, which persisted well after the tech bust at the beginning of the decade, and despite the Bush administration's highly stimulative fiscal deficits. Because the Federal Reserve was only willing to counter goods inflation, not asset inflation, Western interest rates in turn were kept lower than they would otherwise have been. As the U.S. Department of Treasury sold bonds to finance the budget deficits, large purchases by Chinese, other Asian, and Middle Eastern countries kept interest rates on those bonds from rising as much as they otherwise would have. Meanwhile, Japan's near-zero interest rates enabled hedge funds and others throughout the world to borrow yen at very low interest rates and invest in every kind of asset, including real estate, stock markets, and private equity, driving asset prices up throughout the world.

Whenever an economy is swamped by excess liquidity and goods inflation is capped, the prices of assets like real estate and stocks rise. Excess money has to go somewhere. When the amount of liquidity is exceptional, the rise of asset prices is similarly exceptional. In all the resulting asset bubbles, financial speculation and

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peculation accelerate. The recycling of China's huge foreign exchange reserves was far from the only source of the tsunami of liquidity, but it was one of the largest. Chinese leaders have angrily denied that Chinese funds and inexpensive exports played this role, but ultimately it is a simple fact. Conversely, Western politicians have been far too quick to blame Chinese currency policies when the actual problem stemmed from the U.S. bubble demand, combined with high Chinese savings rates, that were the inexorable consequences of a huge, young Chinese population desperately needing to save to ensure that their children would receive good educations, and that they themselves would have adequate health care and retirement security given the country's lack of adequate medical insurance, social security, and pensions. The Chinese government was investing proportionately huge sums to address those inadequacies, but the shortfalls were too large to be offset in anything less than decades.

The flood of liquidity would have caused serious bubbles in any imaginable circumstances, but those bubbles as well as the consequences of their collapse

Addressing the problem squarely would require major sacrifices of sovereignty.

were inflated by Western failures: poor bank supervision, congressional refusal to allow tightened regulation of government-backed mortgage institutions, corrupt credit rating procedures, and central bank insistence that it was right to bail out the markets when bubbles burst, but wrong to prick the bubbles when they inflate. Western mismanagement, therefore, ensured maximum damage from excess Eastern liquidity.

The central phenomenon underlying the global financial crisis is a combination of financial globalization and national monetary policy. The surge of liquidity and the management problem it creates are global, but each country manages as if it were an island. Throughout the globe, leaders have refused to face the likelihood that financial globalization is inherently unmanageable by sovereign central banks and economic managers acting independently or with inherently limited G-8 or G-20 coordination. Western politicians have sought to blame the Chinese currency regime for global imbalances—a position that is untenable on the evidence. Chinese politicians have consistently denied that China contributed to the crisis while distinguished Chinese scholars have even claimed that U.S. management of the dollar has been responsible not just for the current financial crisis but also for the earlier Mexican (1994), Russian (1998), and Asian (1997–1998) crises—a position that is even more untenable.

Western leaders have focused their domestic efforts on bank regulation, credit rating agency reforms, inclusion of non-bank financial firms under banking

regulations, and the like—all of which are worthy efforts, but ultimately ignore the much larger problem of damping and managing global financial tsunamis and the resultant bubbles. Addressing the big problem squarely would require major sacrifices of sovereignty, in a move toward some kind of global currency (as Keynes recommended in 1944 during the negotiations that led instead to the Bretton Woods system) or global central bank or both. Will China or any major Western country be willing to contemplate such a sacrifice? It seems unlikely. As a result, future historians may write that this stance ensured that the next crisis will be bigger than the current one.

China's Pre-Crisis Economic Strategy

China's domestic situation and policy misjudgments have magnified the impact of the financial crisis on China itself. Prior to the crisis, China was experiencing what one might call a Jimmy Carter moment: a paradoxical combination of rapidly rising inflation (from near-zero to over eight percent in about two years) and spreading bankruptcies. That seemingly contradictory combination signaled a structural problem, namely a strategy for growth that had been fabulously successful but was becoming obsolescent.

China's spectacular growth had two main drivers. Heavy industry and infrastructure was the first. Chinese development of modern highways, ports, and telecommunications provided the foundation for its rapid development. In every year of the reform era, China built more modern highways than India had built in the entire period since independence in 1947. In support of such efforts to build infrastructure and industry, China's petrochemical, steel, aluminum, and concrete industries, among others, compounded spectacularly. By 2007, China's capacity to make steel constituted 38 percent of world production, dwarfing each of its major competitors—Europe, Japan, and the United States. When the center of gravity of this development of infrastructure and heavy industry was, for instance, highway and rail lines connecting Beijing and Shanghai, the economic payoff was large and immediate. Later, when much of it focused on palatial, redundant shopping malls and luxury property developments, the payoff became negligible to negative. China was driving up the prices of raw materials throughout the world, degrading its own environment, and using vast amounts of capital in the pursuit of drastically diminishing returns.

The second driver of rapid Chinese growth was the use of cheap labor to manufacture and export vast amounts of low-end products: socks, shoes, shirts, toys, basic consumer appliances, and much else. But Chinese wages had been rising very fast for a very long time, and a new labor rights law immensely increased the cost of labor, so this thrust of China's growth strategy was also meeting diminishing returns. Earlier, foreign investors looked primarily to China

when investing in these industries, but as labor costs continued to skyrocket, they started deserting China in droves, favoring cheaper places like Vietnam instead.

For China's success to continue, the next wave of rapid growth will need to focus on higher value-added manufacturing, a shift toward the domestic market, a shift of the center of gravity of growth from the coast to the interior, a vast expansion of the service sector, and the dynamism of small and medium, predominantly private, firms. The response of the current Chinese administration to this new strategic situation prior to the crisis has been far less decisive than the Deng Xiaoping and Jiang Zemin/Zhu Rongji administrations had been. President Hu Jintao and Prime Minister Wen Jiabao have strongly and successfully emphasized a shift toward development of the interior, but the other needed new emphases have appeared only slowly at best.

The reasons go to the heart of China's current political situation. Under Zhu's determined leadership, the structure of China's industry had been transformed at the price of a degree of social stress that is inadequately appreciated in the West. In the decade after 1994, state enterprise jobs declined by 44 million and

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manufacturing jobs by 25 million. By the end of Zhu's brilliant tenure, which saved China from a potentially crippling financial crisis and sustained the economy's rapid economic growth with low inflation, popular opinion had turned sharply against him. How could he have subjected Chinese society to such terrible stresses without completely solving the problems of state enterprises, agricultural backwardness, and

others? Given the improvement of Chinese lives that took place under his tenure, and the magnitude of the problems China faced, this was an unfair judgment on his herculean efforts. Yet, it was socially understandable. The speed of stressful social change in China during those years dwarfed the politically difficult changes in places like Michigan and South Carolina.

The new administration of Hu and Wen, which began in 2003, was a direct reaction to this situation. Both have stood for fairness and stability, rather than rapid marketization and stress. They represent the interests of the interior against the dynamic coast (the Chinese counterparts of Ohio and Wyoming rather than California and New York) and of the poor against the very rich (the AFL-CIO rather than Silicon Valley and Wall Street). Hu's stated goal, the Harmonious Society, has meanings on many levels. At the loftiest level, it represents a forward-looking replacement for the Leninist-Maoist political dynamic of class struggle and class dictatorship with a post-Marxist acknowledgement of the realities of an emergent middle class society, along with the possibility of

governance based on largely shared middle class interests. At the operational level, it repudiates the ruthless marketization, inequality, and social and environmental stress of the preceding decade.

Another core theme of the new administration, similarly supported at great depth by Chinese opinion, was to replace the era of rule by great men pursuing transformative goals through a process of political struggle. The new era was to be characterized by peaceful transfer of power, enhanced rule of law, and collective leadership by politicians doing their designated jobs within their designated boxes, rather than by great men seizing power and doing whatever was necessary to move China forward. President Jiang Zemin (1989–2004) had been labeled the Core of the Third Generation; there was to be no core of the fourth generation. The noble aspect of this change was that it brought China to a new level of political maturity. The risk was that, without the driving force of great men, it would be difficult to move this gigantic population, with its colossal bureaucracies, decisively forward. Structural change, therefore, entailed a fundamentally new leadership style. In terms of U.S. football, Deng, Jiang, and Zhu played offense; Hu and Wen play defense. They play for stability, order, fairness, and social and environmental amelioration.

These were valid ideals and perhaps, in the wake of Jiang and Deng, they were social imperatives. Chinese politics needed order, and the Chinese people deserved a rest. In many ways, the history of China in the reform era was like a man being chased by a tiger. If you focus on the man, you are impressed by the extraordinary speed at which he runs. If you focus on the tiger—China's frightening problems of unemployment, urbanization, environmental deterioration, and many others—then you are impressed that the man is barely able to avoid being eaten. (This has given rise to two separate literatures on China: “the rise of” and “the coming collapse of” genres.) Hu, Wen, and millions of others wanted a rest but there came the tiger, in this case represented by the need to embark on a revised economic path at a very serious social and political cost.

The Financial Crisis and China's Crossroads

The new path required many things, among which two stand out. China would have to abandon a wide swath of low-end manufacturing at the cost of many jobs, or at least millions of people changing jobs. The production of socks and towels has moved over the last half century from South Carolina to Osaka to Seoul/Taipei to Java/Malaysia/Thailand to China and now on to Sri Lanka and Vietnam. Nevertheless, China's manufacturing job losses have already been great and the imperative for further rapid change is a tough challenge for the promoters of the Harmonious Society.

The second aspect of the new path is the requirement to surrender political levers of control in return for potentially vast but uncertain gains. To put this in perspective, each major phase of Chinese development has involved such a tradeoff. Under Deng, Chinese leaders acquiesced in the dissolution of rural communes in favor of a return to family farming. With the communes, government and party leaders had direct control of the jobs and livelihoods of almost all the rural population. When they gave up those controls, they took a risk of proportions that Western politicians simply can not imagine. Likewise, when Zhu reformed urban industry, shedding all those state enterprise jobs and stepping back in many other ways from direct controls over urban livelihoods, the party incurred risks beyond description. But those risks paid off in economic growth that transformed the lives of the overwhelming majority of Chinese people so positively, that the regime was far more stable after the risks had been incurred than it was before. As a result of Deng's and Zhu's successful risk-taking,

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top Chinese leaders (though not local leaders) enjoy public approval ratings their Western counterparts can only dream about.

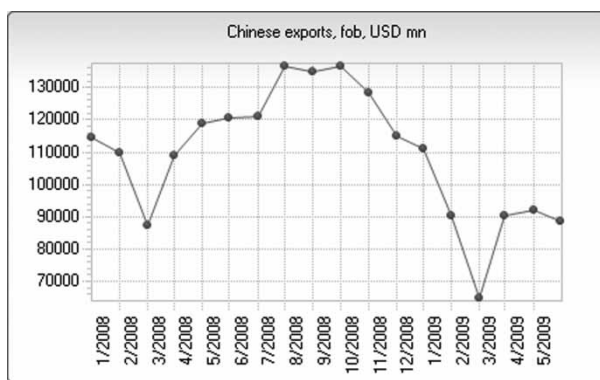
Similarly, the next phase of rapid Chinese development will require the leadership to surrender substantial control over the flow of capital throughout the Chinese economy.

Today, bank loans go mainly to large state enterprises. Listing on the Shanghai stock market is not based on objective economic performance criteria, as in Hong Kong and New York, but rather requires a license. Those licenses are granted mainly—not exclusively but mainly—to large state enterprises. Behind these controls lie both a genuine social purpose and a crucial political concern. China's leaders want to preserve and enhance the value of state enterprises as a way to fund the seemingly overwhelming financial costs of the medical insurance, social insurance, and pensions China so desperately needs. They have to do this in less than a decade, before a graying society makes those costs insurmountable. But to take the Chinese economy to the next level, they are going to have to risk: subjecting those firms to the full force of competitive markets; witnessing the potential decline of high stock market prices that make paying for a social safety net seem (barely) possible; and sacrificing much of the enormous political leverage that derives from ultimate control over the flow of capital. This phase is not as risky as the ones Deng and Zhu launched, but it is immeasurably greater than the risks the Obama administration is taking with health care reform. For the leaders of the defense squad—with their emphasis on order, stability, control, fairness, and harmony—this is a formidable challenge.

As a result, the new team was slow to move toward a new growth path. But pressures mounted, and the leaders have good advisors fully aware of the emerging economic realities, so in mid-decade they started to move. The currency was allowed to appreciate over 20 percent from \$8.28 in June 2005 to \$6.83 in August 2009. More importantly, when wages were already quickly rising because of a tight labor market, a new labor law took effect on January 1, 2008, drastically raising labor costs. The exact costs are controversial and difficult to calculate because one of the biggest varied greatly among companies: a requirement for employers who laid off workers to pay out the workers depending on their tenure with the firm. U.S. labor leaders deny that the law raised costs as much as 40 percent; many employers assert that they rose 200–300 percent. A survey by the Hong Kong Federation of Industries (HKFI) published in October 2008 found that, of the 70,000 firms in China owned by their members, 20 percent were either out of business or being phased out. The owners primarily blamed the new labor law for this development, which preceded the full demand collapse caused by the global financial crisis. (Perceptions may well have conflated the impacts of inflation, market-based wage rises, and the new labor law, but in interviews top U.S. executives emphatically confirmed the devastating cost increases imposed by the new labor law.) In the world capital of toy manufacturing, 53 percent of all toy companies (by number, not dollar volume) had collapsed by October 2008, before the effects of the financial crisis had really hit.¹

At this point, the global financial crisis hit. The preexisting deleterious domestic combination of rising currency, market-based wage rises, and the residual effects of the previous years' inflation was suddenly magnified by a global collapse of demand. Foreign companies fled China. Local companies closed. Managers who didn't have the funds for the required payouts to laid-off workers fled to Taiwan and elsewhere. As shown in the accompanying chart,² Chinese exports declined drastically in early 2009 as compared with 2008:

Figure I: Declining Chinese Exports



According to official calculations, about 20 million workers lost their jobs (in the business community and among many economists, the number was believed to be far higher). Coastal China was vulnerable and was hit hard.

The loss of tens of millions of jobs supplemented another domestic trend, namely the rapid rise over the years in the number of “mass incidents,” or popular demonstrations. According to official statistics, these had risen from 8,700 in 1993 to about 40,000 in the year 2000, compounded by increasing size, violence, and effectiveness of the protests, with a further rise to 74,000 in 2004.³ Official statistics do not yet reveal the scale of the additional impact of the financial crisis, but there have been many widely publicized protests by workers losing their jobs. This led some Western commentators to speculate that regime stability could be threatened, although that seems extremely unlikely. Everything we know about the demonstrations is that they are directed at local businesses and local government and party officials. In almost all cases, they constitute an effort to attract the attention of the central government, which according to credible polls is generally regarded as doing a good job under difficult circumstances, whereas sub-provincial governments are generally regarded with something between disdain and angry contempt.⁴ It is, of course, not impossible to imagine that a deep economic downturn, sustained for years, could redirect these local disturbances into coalesced disaffection toward the central government. But that scenario is far removed from current realities.

Having said this, demonstrations were sufficiently numerous and vehement to raise strong central government concern about the risk of even wider unemployment and even deeper mass disaffection. In particular, the government became relatively cautious regarding issues that could exacerbate unrest. The rise of the currency ceased, since a rising currency would make more imports uncompetitive and add to unemployment. In some cases, the central government called off important plans, such as the sale of the Linzhou Iron and Steel Co. in Henan, when confronted by violent worker protests.⁵

Responding to the Financial Crisis

Given the regime’s awareness that it derives its legitimacy from strong economic performance, Beijing responded decisively to the financial crisis. On November 9, 2008, it announced a fiscal stimulus of RMB 4 trillion (\$586 billion). The exact incremental stimulative effect was difficult to pin down because some of the expenditures may have been previously budgeted and much of the burden of funding projects was directed to local governments, whose obedience is imperfect. But there was no doubt about the massive scale of the stimulus and its effect on project spending throughout China.

Officials reported that, whereas the central government had previously acted to constrain local governments from implementing projects that seemed to be of dubious value, now the pressures flipped to very serious criticism of those same local governments for not implementing even more projects quickly enough. Compared to the United States, China had many more shovel-ready projects and its system presented fewer legal or regulatory obstacles to their rapid implementation. Moreover, the Chinese fiscal stimulus was far more focused on actual crisis stimulus than its U.S. counterpart, which was heavily a social improvement agenda that included health care, education, alternative energy, and the like (as contrasted for instance with revamping badly deteriorated physical infrastructure), and with spending spread out over a good many years.

As in the United States, China's monetary stimulus probably had far greater economic impact, and far more immediate impact, than the fiscal stimulus. In China, monetary and fiscal stimuli overlapped and reinforced each other to a far greater extent because China's monetary stimulus, in a well-capitalized banking system, was channeled much more into actual projects. U.S. monetary policy had to focus on bailing out a collapsing financial system. Having come off a restrictive anti-inflation policy, starting in September 2008 the central bank cut Chinese interest rates three times by 0.27 percent each time and then by 1.08 percent in November to a deposit rate of 2.52 percent. More importantly, it cut the highly restrictive requirements for bank reserves and mandated such sharp increases in lending that many observers were alarmed.⁶

The government's efforts to stimulate short-term economic activity were unquestionably successful. Fixed asset investment in the first half of 2009 rose 33.5 percent over its 2008 counterpart, and according to official statistics, gross domestic product (GDP) growth in the first quarter of 2009 was 6.1 percent, followed by 7.9 percent in the second quarter. GDP growth in Chongqing, China's largest city and the center of gravity of central government efforts to develop the relatively backward interior, was running in excess of a 15 percent annual rate.⁷ Supported by central government subsidies for the purchase of consumer electronics and appliances, national retail spending in the first half of 2009 grew 15 percent. August 2009 real estate investment was up 14.7 percent over August 2008. Sectoral results provided supportive evidence of revival. In early 2009, China surpassed the United States for the first time in total car sales and was expected by brokerage analysts to sustain that lead for the full year by selling 10–11 million cars. Enhanced as elsewhere by stimulus programs, Chinese car sales in June 2009 rose 48 percent over 2008—General Motors' sales in

China's growth in fact comes predominantly from domestic sources.

China that month were up 38 percent. Asset prices also reflected recovery. By summer 2009, property prices in Shanghai and other major cities were back to their peak 2007 bubble levels. By mid-July 2009, the Shanghai stock market had gained 75 percent over its level at the beginning of the year.

Some anomalous statistics raised eyebrows. Local governments, under powerful central pressure to perform, clearly were inflating their statistics. (They always do, and the central government always deflates their claimed performance, but the peculiarities now became much greater and could have created serious distortions in late 2008 and early 2009.) Journalists argued that the rapid decline of exports was inconsistent with good economic growth in an economy whose growth is export-led, although that was easily explained. Contrary to Western conventional wisdom, China's growth in fact comes predominantly from domestic sources, not from exports, and trade actually contributed to positive economic growth early in the crisis because imports declined even faster than plummeting exports. A greater anomaly was a decline in energy usage, but that anomaly could not offset the evidence from many sectors and innumerable companies that, by the summer, growth was quite vigorous.

By July 2009, the government was sufficiently confident about recovery, and sufficiently concerned about asset bubbles, that it started applying the monetary brakes. The volume of new lending by Chinese banks slowed by 77 percent in July 2009 compared with June⁸ and the pace of economic growth slowed slightly.⁹ China had stepped on the accelerator more decisively than the rest of the world and started applying the monetary brakes correspondingly earlier, thereby seeming to set a gold standard for crisis management.

What Now?

There remain two levels of questions about the future. The first concerns the hangovers from the stimulus, which will be ubiquitous. Top bankers acknowledge that there will be a hangover of bad loans in China as a result of the hasty approval of numerous projects that would never have passed reviews before the stimulus. We will not know the scale of the bad loans for at least a couple years, but the consensus is that they will not be crippling. The big banks, chastened by their difficulties of a decade ago, were more cautious than the statistics indicate. Increasingly capable credit departments were supplemented by gamesmanship in meeting Beijing's lending targets: just under one-third of their increased "lending" may have been a virtually risk-free exchange of notes among themselves.¹⁰ The problems will fall primarily on smaller banks.

The financial stimulus completely reinflated the property market in major cities. The government not only bailed out the market but also all the major property developers. Market insiders say that bubble psychology has completely

and dangerously revived. In this sector, the Chinese government has particularly set the global lead standard for creating moral hazard. There will eventually be a substantial price to pay. Likewise, the spectacular rise in the Shanghai stock market may prove to be unsustainable.

There has also been some damage to the integrity of the corporate decisionmaking process. Numerous companies have been reallocating resources to what the Japanese in their bubble era called *zaitech*—financial engineering. They have shifted funds from making widgets to investing in the stock market, property developments, shares of banks, and even private equity ventures. It remains to be seen whether Beijing can arrest this trend. Given the decisiveness of the government's other moves, it could prove decisive here also, but the question remains until data answers it. Meanwhile, household savings were falling in the summer of 2009 (e.g., by RMB 19.2 billion in July) as families shifted out of savings into the stock market.

At the second and more strategic level, the crucial question for China's economic future is whether the government can push the economy onto a new growth path that builds on, but moves beyond, obsolescent strategies based on overinvesting in heavy industry and relying for employment on extremely cheap labor. Small and medium industries, the service sector, and the private sector appear to have been severely damaged by the crisis. As elsewhere, the stimulus has flowed into older sectors—the state enterprises that could create jobs quickly and were more likely to be able to pay back their loans. On this level, the need for new directions comes solidly up against the apparently strong inclination of the Hu administration to continue to rely heavily on state enterprises for political control. As is likely to happen elsewhere, Chinese leaders continue to push stimulus programs when the economy seems to them not to have fully revived. The result in China is inflation of property and stock markets while the prices of goods deflate due to overcapacity. The only solution is to let firms go bankrupt until overcapacity and obsolete capacity have evaporated, while creating new jobs to replace the lost ones. As everywhere else, the only kinds of firms in China that can create massive numbers of jobs quickly are small, medium, largely private sector enterprises in higher-value manufacturing and services. Whether China's current leadership can grasp this and make necessary decisions, notwithstanding the associated political grief, remains to be seen.

One positive glimmer is the long-delayed plan to open the Growth Enterprise Market in Shenzhen during October 2009, which is designed to support small companies. Another glimmer is enthusiastic government support for private

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The financial crisis highlighted the reality of a new order in Asia and, to some extent, the world.

equity funds, which would channel capital toward more efficient uses than constrained banks and stock markets. But these are as yet small glimmers. Decisive moves toward a new path might have to await the arrival in 2013 of the next administration, key candidates for which are believed to be more market-oriented.

Is China Rising Faster after the Crisis?

While the Bush administration had begun with efforts to implement the Armitage Report's recommendations,¹¹ that Washington should take China less seriously and emphatically make Japan the fulcrum of U.S. relations with Asia, the Obama administration began with talk about the G-2—the two decisive powers, China and the United States, who could act when others could not.¹² Whereas the Reagan administration began with campaign promises to upgrade relations with Taiwan, the Clinton administration with promises to revoke China's Most Favored Nation status, and the George H. W. Bush administration with efforts to reorient the U.S. military toward the China threat, the new Obama administration immediately muffled the analogous campaign rhetoric about the Chinese currency and cut back on budgets for China-directed high-tech weaponry.

This change did not reflect merely a new U.S. administration but began during the last one. The U.S. Department of State under George W. Bush had become disillusioned with Japanese opposition to the U.S.-China approach to North Korea. Similarly, the Department of Defense had become disillusioned at Japan's unwillingness to appropriate funds for transfer of the Futenma base 15 years after that transfer had been agreed. All of Washington had become as disheartened as the Japanese people, who were heading toward repudiation of an incompetent and indecisive Liberal Democratic Party government that was uninterested in fixing the Japanese economy and diplomatically capable only of healing some of the damage and isolation that the Japanese right wing had previously caused by alienating Japan's Asian neighbors. Meanwhile, on North Korea, terrorists, regional crime, drug trafficking and trade, investment, and agricultural issues, the United States was surprisingly finding China as a partner with whom business could get done and decisions could be taken.

Both Democrats and Republicans held back from articulating the great shift that had taken place gradually over the previous decade. The G-2 concept was both too strong and somewhat ideologically obscene for polite Washington discourse. The Chinese government recoiled from the responsibility implied by

the phrase, even though China has gradually shifted from complete denial of leadership responsibility (for instance on North Korea) to taking considerable pride in its expanding leadership role and even asserting a right to leadership in some areas. The idea that Japan was an ineffectual partner remained as politically incorrect in Washington as the notion that China was the principal Asian country with which the United States could get things done. In addressing the global financial crisis, however, China and the United States have had a strong partnership. The necessity of working closely with Beijing during the crisis even muted congressional outcry about the Chinese currency and the loss of lucrative aircraft and naval contracts.

The global financial crisis did not change the shape of the Pacific or global politics. It accelerated changes that had been long under way and illuminated them to a degree that will make continued denial of the new post-Cold War relationships increasingly untenable. Some will celebrate the new reality; many will recoil from it. But, whatever political valence is applied, the financial crisis highlighted the reality of a new order in Asia and to some extent in the world. Washington and Beijing could make big decisions and deploy vast resources in a focused way. Brussels, New Delhi, and Tokyo could not. As Chinese demand gradually restored growth in Japan and other Asian countries, the new realities were far more quickly acknowledged in Asia than in Washington.

Notes

1. The statistics on HKFI member-owned companies and toy company bankruptcies, along with the HKFI members' interpretations of the causes, are from a presentation of HKFI findings at the International Chamber of Commerce annual meeting in Hong Kong in October 2008.
2. See CEIC Data, Web site, <http://www.ceicdata.com/>. (Detailed information only available for subscribers).
3. For a detailed analysis of the statistics on mass incidents, including the 1993 and 2000 numbers, see Murray Scot Tanner, "China Rethinks Unrest," *The Washington Quarterly* 27, no. 3 (Summer 2004): 137–156, http://www.twq.com/04summer/docs/04summer_tanner.pdf. For the source on the 2004 number, see "Senior Chinese Officials Acknowledge Rising Social Unrest, but Rule Out Political Liberalization," Congressional-Executive Commission on China, July 4, 2005, <http://www.cecc.gov/pages/virtualAcad/index.phpd?showsingle=17209>.
4. See Tony Saich, "The Changing Role of Urban Government," in Shahid Yusuf and Tony Saich, *China Urbanizes: Consequences, Strategies, and Policies* (Washington, D.C.: The World Bank, 2008), pp. 195–196, 200.
5. See Shai Oster, "Beijing Calls Off Sale of Steel Mill," *Wall Street Journal*, August 17, 2009, <http://online.wsj.com/article/SB125043783917034879.html>.
6. For example, see the quotations from economists of leading banks in "China Bank Lending: A Bubble in the Making?" CNN, July 24 2009, <http://edition.cnn.com/2009/BUSINESS/07/24/china.record.lending/index.html>.

7. This writer spent a week in Chongqing in July 2009. Senior government officials gave credible accounts of rapid economic growth. Every company visited reported rapid growth. According to official statistics, second quarter GDP growth was 15.7 percent over the previous year.
8. See Chris Oliver, "China Bank Lending Fell Almost 77% in July," *MarketWatch*, August 11, 2009, <http://www.marketwatch.com/story/china-bank-lending-falls-almost-77-in-july-2009-08-11>.
9. See Jamil Anderlini, "China's Economy Cools as Lending Slows," *Financial Times*, August 11, 2009, <http://www.ft.com/cms/s/0/06871ef4-8630-11de-98de-00144feabdc0.html>.
10. See Fang Huilei, Wen Xiu, Yu Ning, and Song Yanhua, "New Bank Loans Soar to 1.6 Trillion Yuan," *Caijing Online*, February 12, 2009, <http://www.caijing.com.cn/2009-02-11/110054980.html> (in Chinese).
11. Richard Armitage and Joseph Nye, "The United States and Japan: Advancing Toward a Mature Partnership," *INSS Special Report* (Washington, D.C.: Institute for National Strategic Studies [INSS], October 2000), http://www.ndu.edu/inss/strforum/SR_01/SR_Japan.htm.
12. The phrase G-2, coined by Fred Bergsten, remains politically incorrect but is in common use. To read more about how most great Asian issues would inevitably end up being managed by a U.S.–China bicondominium, see William H. Overholt, *Asia, America and the Transformation of Geopolitics* (Cambridge, MA: Cambridge University Press, 2007).