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The Chinese Century, by Joseph E. Stiglitz

Without fanfare—indeed, with some misgivings about its new status—China has just overtaken the United States as the world’s largest economy. This is, and should be, a wake-up call—but not the kind most Americans might imagine.



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For America, the best response to China is to put our own house in order.

When the history of 2014 is written, it will take note of a large fact that has received little attention: 2014 was the last year in which the United States could claim to be the world’s largest economic power. China enters 2015 in the top position, where it will likely remain for a very long time, if not forever. In doing so, it returns to the position it held through most of human history.

Comparing the gross domestic product of different economies is very difficult. Technical committees come up with estimates, based on the best judgments possible, of what are called “purchasing-power parities,” which enable the comparison of incomes in various countries. These shouldn’t be taken as precise numbers, but they do provide a good basis for assessing the relative size of different economies. Early in 2014, the body that conducts these international assessments—the World Bank’s International Comparison Program—came out with new numbers. (The complexity of the task is such that there have been only three reports in 20 years.) The latest assessment, released last spring, was more contentious and, in some ways, more momentous than those in previous years. It was more contentious precisely because it was more momentous: the new numbers showed that China would

become the world's largest economy far sooner than anyone had expected—it was on track to do so before the end of 2014.

The source of contention would surprise many Americans, and it says a lot about the differences between China and the U.S.—and about the dangers of projecting onto the Chinese some of our own attitudes. Americans want very much to be No. 1—we enjoy having that status. In contrast, China is not so eager. According to some reports, the Chinese participants even threatened to walk out of the technical discussions. For one thing, China did not want to stick its head above the parapet—being No. 1 comes with a cost. It means paying more to support international bodies such as the United Nations. It could bring pressure to take an enlightened leadership role on issues such as climate change. It might very well prompt ordinary Chinese to wonder if more of the country's wealth should be spent on them. (The news about China's change in status was in fact blacked out at home.) There was one more concern, and it was a big one: China understands full well America's psychological preoccupation with being No. 1—and was deeply worried about what our reaction would be when we no longer were.

Of course, in many ways—for instance, in terms of exports and household savings—China long ago surpassed the United States. With savings and investment making up close to 50 percent of G.D.P., the Chinese worry about having too much savings, just as Americans worry about having too little. In other areas, such as manufacturing, the Chinese overtook the U.S. only within the past several years. They still trail America when it comes to the number of patents awarded, but they are closing the gap.

The areas where the United States remains competitive with China are not always ones we'd most want to call attention to. The two countries have comparable levels of inequality. (Ours is the highest in the developed world.) China outpaces America in the number of people executed every year, but the U.S. is far ahead when it comes to the proportion of the population in prison (more than 700 per 100,000 people). China overtook the U.S. in 2007 as the world's largest polluter, by total volume, though on a per capita basis we continue to hold the lead. The United States remains the largest military power, spending more on our armed forces than the next top 10 nations combined (not that we have always used our military power wisely). But the bedrock strength of the U.S. has always rested less on hard military power than on "soft power," most notably its economic influence. That is an essential point to remember.

Tectonic shifts in global economic power have obviously occurred before, and as a result we know something about what happens when they do. Two hundred years ago, in the aftermath of the Napoleonic Wars, Great Britain emerged as the world's dominant power. Its empire spanned a quarter of the globe. Its currency, the pound sterling, became the global reserve currency—as sound as gold itself. Britain, sometimes working in concert with its allies, imposed its own trade rules. It could discriminate against importation of Indian textiles and force India to buy British cloth. Britain and its allies could also insist that China keep its markets open to opium, and when China, knowing the drug's devastating effect, tried to close its borders, the allies twice went to war to maintain the free flow of this product.

Britain's dominance was to last a hundred years and continued even after the U.S. surpassed Britain economically, in the 1870s. There's always a lag (as there will be with the U.S. and China). The transitional event was World War I, when Britain achieved victory over Germany only with the assistance of the United States. After the war, America was as reluctant to accept its potential new responsibilities as Britain was to voluntarily give up its role. Woodrow Wilson did what he could to construct a postwar world that would make another global conflict less likely, but isolationism at home meant that the U.S. never joined the League of Nations. In the economic sphere, America insisted on going its own way—passing the Smoot-Hawley tariffs and bringing to an end an era that had seen a worldwide boom in trade. Britain maintained its empire, but gradually the pound sterling

gave way to the dollar: in the end, economic realities dominate. Many American firms became global enterprises, and American culture was clearly ascendant.

World War II was the next defining event. Devastated by the conflict, Britain would soon lose virtually all of its colonies. This time the U.S. did assume the mantle of leadership. It was central in creating the United Nations and in fashioning the Bretton Woods agreements, which would underlie the new political and economic order. Even so, the record was uneven. Rather than creating a global reserve currency, which would have contributed so much to worldwide economic stability—as John Maynard Keynes had rightly argued—the U.S. put its own short-term self-interest first, foolishly thinking it would gain by having the dollar become the world's reserve currency. The dollar's status is a mixed blessing: it enables the U.S. to borrow at a low interest rate, as others demand dollars to put into their reserves, but at the same time the value of the dollar rises (above what it otherwise would have been), creating or exacerbating a trade deficit and weakening the economy.

For 45 years after World War II, global politics was dominated by two superpowers, the U.S. and the U.S.S.R., representing two very different visions both of how to organize and govern an economy and a society and of the relative importance of political and economic rights. Ultimately, the Soviet system was to fail, as much because of internal corruption, unchecked by democratic processes, as anything else. Its military power had been formidable; its soft power was increasingly a joke. The world was now dominated by a single superpower, one that continued to invest heavily in its military. That said, the U.S. was a superpower not just militarily but also economically.

The United States then made two critical mistakes. First, it inferred that its triumph meant a triumph for everything it stood for. But in much of the Third World, concerns about poverty—and the economic rights that had long been advocated by the left—remained paramount. The second mistake was to use the short period of its unilateral dominance, between the fall of the Berlin Wall and the fall of Lehman Brothers, to pursue its own narrow economic interests—or, more accurately, the economic interests of its multi-nationals, including its big banks—rather than to create a new, stable world order. The trade regime the U.S. pushed through in 1994, creating the World Trade Organization, was so unbalanced that, five years later, when another trade agreement was in the offing, the prospect led to riots in Seattle. Talking about free and fair trade, while insisting (for instance) on subsidies for its rich farmers, has cast the U.S. as hypocritical and self-serving.

And Washington never fully grasped the consequences of so many of its shortsighted actions—intended to extend and strengthen its dominance but in fact diminishing its long-term position. During the East Asia crisis, in the 1990s, the U.S. Treasury worked hard to undermine the so-called Miyazawa Initiative, Japan's generous offer of \$100 billion to help jump-start economies that were sinking into recession and depression. The policies the U.S. pushed on these countries—austerity and high interest rates, with no bailouts for banks in trouble—were just the opposite of those that these same Treasury officials advocated for the U.S. after the meltdown of 2008. Even today, a decade and a half after the East Asia crisis, the mere mention of the U.S. role can prompt angry accusations and charges of hypocrisy in Asian capitals.

Now China is the world's No. 1 economic power. Why should we care? On one level, we actually shouldn't. The world economy is not a zero-sum game, where China's growth must necessarily come at the expense of ours. In fact, its growth is complementary to ours. If it grows faster, it will buy more of our goods, and we will prosper. There has always, to be sure, been a little hype in such claims—just ask workers who have lost their manufacturing jobs to China. But that reality has as much to do with our own economic policies at home as it does with the rise of some other country.

On another level, the emergence of China into the top spot matters a great deal, and we need to be aware of the implications.

First, as noted, America's real strength lies in its soft power—the example it provides to others and the influence of its ideas, including ideas about economic and political life. The rise of China to No. 1 brings new prominence to that country's political and economic model—and to its own forms of soft power. The rise of China also shines a harsh spotlight on the American model. That model has not been delivering for large portions of its own population. The typical American family is worse off than it was a quarter-century ago, adjusted for inflation; the proportion of people in poverty has increased. China, too, is marked by high levels of inequality, but its economy has been doing some good for most of its citizens. China moved some 500 million people out of poverty during the same period that saw America's middle class enter a period of stagnation. An economic model that doesn't serve a majority of its citizens is not going to provide a role model for others to emulate. America should see the rise of China as a wake-up call to put our own house in order.

Second, if we ponder the rise of China and then take actions based on the idea that the world economy is indeed a zero-sum game—and that we therefore need to boost our share and reduce China's—we will erode our soft power even further. This would be exactly the wrong kind of wake-up call. If we see China's gains as coming at our expense, we will strive for “containment,” taking steps designed to limit China's influence. These actions will ultimately prove futile, but will nonetheless undermine confidence in the U.S. and its position of leadership. U.S. foreign policy has repeatedly fallen into this trap. Consider the so-called Trans-Pacific Partnership, a proposed free-trade agreement among the U.S., Japan, and several other Asian countries—which excludes China altogether. It is seen by many as a way to tighten the links between the U.S. and certain Asian countries, at the expense of links with China. There is a vast and dynamic Asia supply chain, with goods moving around the region during different stages of production; the Trans-Pacific Partnership looks like an attempt to cut China out of this supply chain.

Another example: the U.S. looks askance at China's incipient efforts to assume global responsibility in some areas. China wants to take on a larger role in existing international institutions, but Congress says, in effect, that the old club doesn't like active new members: they can continue taking a backseat, but they can't have voting rights commensurate with their role in the global economy. When the other G-20 nations agree that it is time that the leadership of international economic organizations be determined on the basis of merit, not nationality, the U.S. insists that the old order is good enough—that the World Bank, for instance, should continue to be headed by an American.

Yet another example: when China, together with France and other countries—supported by an International Commission of Experts appointed by the president of the U.N., which I chaired—suggested that we finish the work that Keynes had started at Bretton Woods, by creating an international reserve currency, the U.S. blocked the effort.

And a final example: the U.S. has sought to deter China's efforts to channel more assistance to developing countries through newly created multilateral institutions in which China would have a large, perhaps dominant role. The need for trillions of dollars of investment in infrastructure has been widely recognized—and providing that investment is well beyond the capacity of the World Bank and existing multilateral institutions. What is needed is not only a more inclusive governance regime at the World Bank but also more capital. On both scores, the U.S. Congress has said no. Meanwhile, China is trying to create an Asian Infrastructure Fund, working with a large number of other countries in the region. The U.S. is twisting arms so that those countries won't join.

The United States is confronted with real foreign-policy challenges that will prove hard to resolve: militant Islam; the Palestine conflict, which is now in its seventh decade; an aggressive Russia, insisting on asserting its power, at least in its own neighborhood; continuing threats of nuclear proliferation. We will need the cooperation of China to address many, if not all, of these problems.

We should take this moment, as China becomes the world's largest economy, to "pivot" our foreign policy away from containment. The economic interests of China and the U.S. are intricately intertwined. We both have an interest in seeing a stable and well-functioning global political and economic order. Given historical memories and its own sense of dignity, China won't be able to accept the global system simply as it is, with rules that have been set by the West, to benefit the West and its corporate interests, and that reflect the West's perspectives. We will have to cooperate, like it or not—and we should want to. In the meantime, the most important thing America can do to maintain the value of its soft power is to address its own systemic deficiencies—economic and political practices that are corrupt, to put the matter baldly, and skewed toward the rich and powerful.

A new global political and economic order is emerging, the result of new economic realities. We cannot change these economic realities. But if we respond to them in the wrong way, we risk a backlash that will result in either a dysfunctional global system or a global order that is distinctly not what we would have wanted.