GLOBAL ECONOMY

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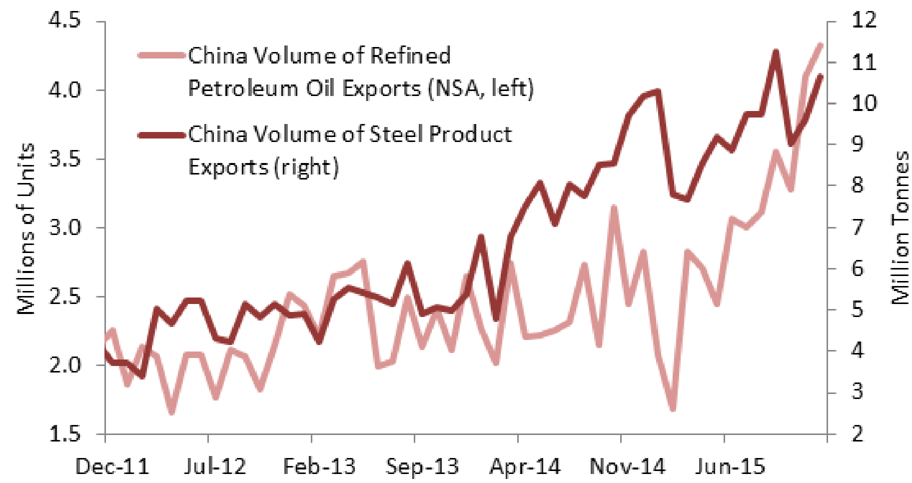
China's Slowdown: A Step Toward Trade Wars and Deglobalization

Global growth will remain weak this year, probably close to but below 3 percent. One big risk stems from China, where the fallout from a shift in policy is already sparking protectionism — a step toward trade wars and the rolling-back of globalization.

China's centrally planned model was built for demand growth that hasn't come through. This bad resource-allocation decision has led to excess capacity and even saturation. China is moving to cut fixed-asset investment, as part of a shift to focus on quality rather than quantity in its production industries. But smelters and refiners (usually state-supported companies) are still producing at levels exceeding demand, meaning China has no choice but to export its commodity production (steel, cement, aluminum, refined oil and so on). Chinese officials invested too much in these sectors and are not able to withdraw their support immediately without risking a wave of defaults.

The central government has cut taxes on exports for several commodities (recently steel billet and pig iron) while the People's Bank of China has let the yuan devalue. Unsurprisingly, steel and refined petroleum exports reached records in December, threatening producers from Asia to the U.S. and aggravating trade disputes. The increase in exports has also contributed to the collapse in global commodities prices.

China's Rising Exports



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The immediate consequence is that new protectionism barriers are going up. On Dec. 22, the U.S. Department of Commerce said that "corrosion-resistant steel imports from China were sold at unfairly low prices and would be taxed at 256 percent." Elsewhere, Indian Secretary of Steel Aruna Sundararajan said in a late December interview that "India plans to step up its protection for debt-laden domestic steelmakers by imposing a minimum price on steel imports among other measures."

The European Commission is set to propose market-economy status (MES) for China as early as February, but I would not be surprised to see strong opposition emerging in the coming days as the move would make it much harder to retaliate against Chinese dumping with countervailing tariffs. The left-leaning Economic Policy Institute in Washington estimates that granting MES status to China would endanger as many as 3.5 million jobs in the EU.

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