March 5, 2012

Enough is Enough: Confronting Chinese Innovation Mercantilism

ITIF

The Information Technology and Innovation Foundation (ITIF) is a Washington, D.C.-based think tank at the cutting edge of designing innovation policies and exploring how innovation will create new opportunities to boost economic growth and improve quality of life. ITIF focuses on:

- Innovation "verticals": energy, life sciences, telecom, manufacturing, and Internet and IT transformation
- Innovation "horizontals": trade, tax, talent, and tech policy
- "Innovation economics" as an alternative to mainstream economics

What is Innovation Mercantilism (IM)?

- IM is an economic strategy to grow a nation's economy by reducing imports and expending exports of higher value-added industries through policies which violate the spirit or the letter of the law of the WTO.

Since 2006, IM Has Been at the Center of China's Economic Strategy

Early 2000s:
Multinational corporations (MNCs) benefited from access to a low-cost production platform and American consumers benefited from lower-cost goods. And while China occasionally engaged in policies that brought complaints from U.S. industry, by and large U.S. industry was satisfied with the relationship.

2006:
Chinese leaders decided attracting commodity-based production facilities from MNCs was no longer the goal. The path to prosperity and autonomy was now to be "indigenous innovation."

Implementation of the National Medium- and Long-term Program for Science and Technology Development (2006-2020).

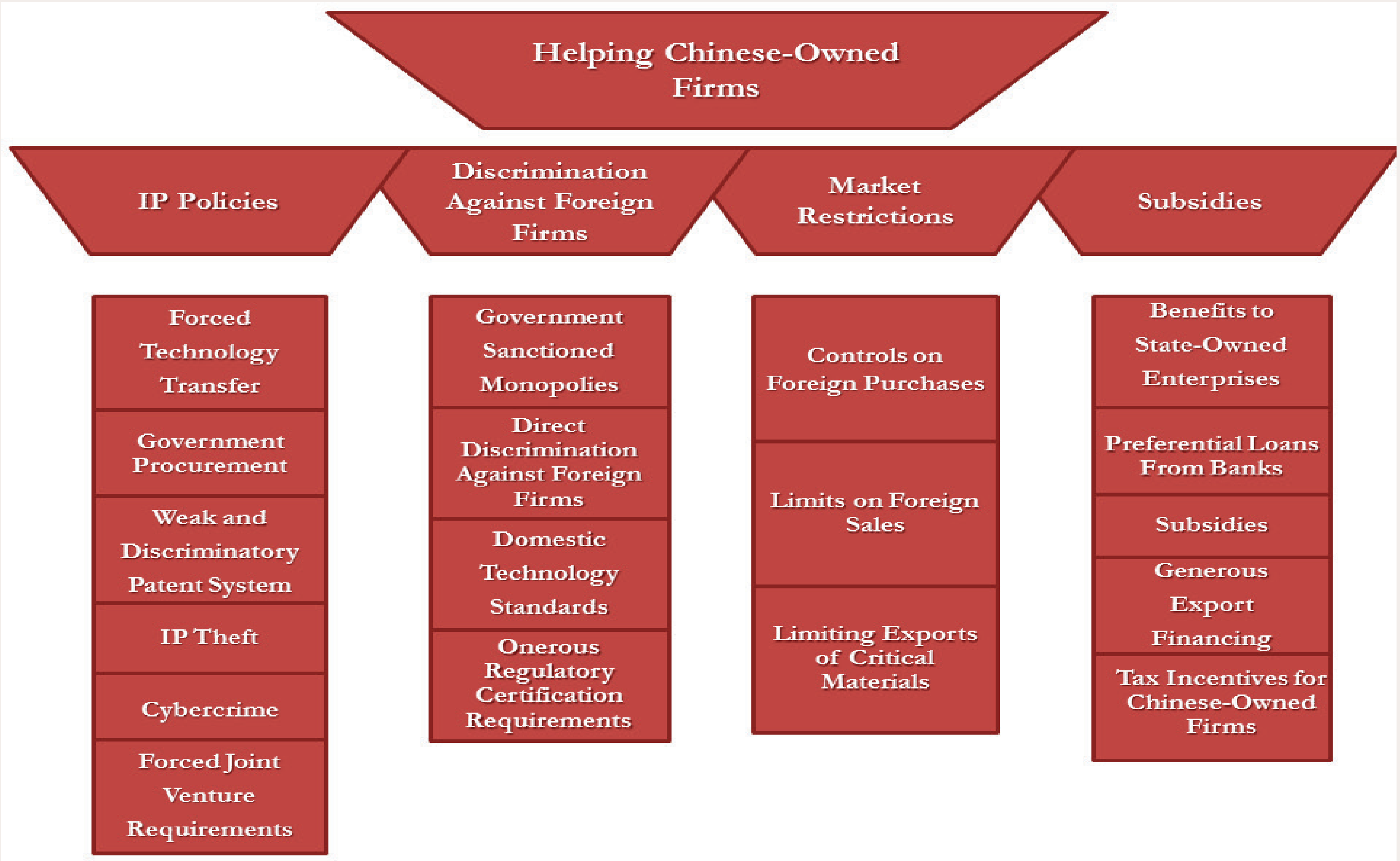
After the MLP China was to seek the capability to master virtually all advanced technologies, with the focus on Chinese firms gaining those capabilities through "indigenous innovation."

China's IM Strategy is to Force Tech Transfer

- Chinese innovation capabilities are limited and rather than grow them organically over time, China's strategy is to use IM to support "indigenous innovation" to gain advantage over foreign rivals.

- "We must improve our capabilities for original innovation, integrated innovation and re-innovation through digesting introduced technologies to transform to an innovation-driven economy and society." (Chinese President Hu Jintao, December, 2011).

China's IM is Focused on Helping Chinese-Owned Firms Grow Through an Array of Policies



China Seeks Absolute Advantage

- Most nations practice comparative advantage: being good at some things and relying on trade for the rest

- China seeks not merely competitive advantage, but *absolute advantage*. In other words, China's strategy is to win in virtually all industries, especially advanced technology products and services.

China Does Not Need IM to Grow

1. There is no correlation between a medium or large-sized nation's balance of trade and its unemployment rate.

2. Review of the economic literature on trade and job creation shows, "In the long run, aggregate net employment largely is unaffected by international factors."

3. If China didn't run trade surpluses, Chinese households would on average see a 17 percent increase in their disposable income.

China's IM Has Hurt the Global Economy

- China's subsidies to keep production cheap move the world production system more towards labor and away from capital, reducing productivity.
- Theft of intellectual property and forced technology transfer reduces revenues going to innovators.
- Manipulation of standards and other limitations on imports bifurcates global markets, keeping them smaller than they otherwise would be, thereby raising global production costs.

Money is No Object

- China's 12th five-year plan focuses on seven "Strategic and Emerging Industries (SEIs), including IT, biotechnology; equipment manufacturing; clean energy, new materials; and new energy vehicles.

- China will invest $1.5 trillion to develop these "strategic sectors" over the next five years.

- For United States to match China's commitment to its SEIs on a per-GDP basis, it would have to pass an American Recovery and Reinvestment Act every year for the next 5 years and dedicate close to 100 percent of the funds to industry.

What Should the United States Do?

Arguments Made Against Taking Action

- "America Benefits From Trade With China, Even if China is Mercantilist."
  - This may be, but China's mercantilist *policies* have hurt U.S. companies, both in the U.S. and in China.

- "America's Economic Travails are Our Fault."
  - This is not an either-or situation. It is important to take steps both at home to be more competitive and overseas to roll back Chinese IM.

- "Getting Tougher With China Will Risk Starting a Trade War."
  - The trade war has already started, it's more than a decade old, and China has fired virtually all of the shots and done almost all of the damage.

Thank You

Robert Atkinson ratkinson@itif.org

Follow ITIF:

facebook.com/innovationpolicy

INNOVATION POLICY BLOG www.innovationpolicy.org

YouTube www.youtube.com/user/techpolicy

ITIF The Information Technology & Innovation Foundation www.itif.org

Twitter: @robatkinsonitif

ITIF
The Information Technology & Innovation Foundation