opinion

China dons provocateur suit

William Pesek
BLOOMBERG

The Communist Party summit that recast Xi Jinping as a reformer extraordinaire has produced its first foreign-policy initiative: poking Japan in the eye.

That seems to be the point of China's declaration of a vast "air-defense identification zone," in which Beijing has essentially claimed the airspace around disputed islands administered by Japan.

The provocation came just two weeks after the party called for a new national security council to coordinate military, domestic and intelligence operations in China. Political analysts who worried that the body might herald a deepening Asian Cold War weren't being entirely paranoid.

There's nothing particularly shocking about establishing such a council, state-run media says. The U.S. and Russia both have one, after all, and even Japan is talking about creating its own.

Besides, as the Xinhua News Agency was kind enough to inform readers in a Nov. 22 explainer piece, "China is a stabilizer for world peace and security, and the new commission is like a performance guarantee for the stabilizer and will in turn bring benefits to the whole world."

Tell that to Itsunori Onodera, Japan's minister of defense, who's working frantically to decode what China means when it warns that its military may take "defensive emergency measures" if planes don't identify themselves in the new air-defense zone.

Or Onodera's South Korean counterpart, Kim Kwan-jin: Some of China's zone overlaps with waters off Jeju Island.

Or Chuck Hagel, the U.S. defense chief, who got dragged into the controversy and responded, boldly, by flying two unarmed B-52 bombers into the area as a warning to Beijing to back off. When he visits Japan, China and South Korea this wee, U.S. Vice President Joe Biden can expect some pretty testy exchanges.

China's move belies all the talk of its peaceful, magnanimous rise as a world power. A tiny accident or miscalculation in the skies above the disputed islands — called the Senkakus by Japan and Diaoyu by China and Taiwan, which separately claim them — could easily spiral out of control, dragging Washington into a clash that would shake the global economy.

Instead of being a stabilizer, China is proving to be a provocateur.

It's hard not to wonder if political testosterone has gone to Xi's head. He emerged from China's recent four-day plenum as the most powerful Chinese leader since Deng Xiaoping. Xi may be especially willing to risk a confrontation with Japan right now in order to distract opponents of his proposed reforms, as well as ordinary Chinese who are growing restless over pollution, income inequality and official corruption.

Nothing brings China's 1.3 billion people together so easily as hating the Japanese.

China doesn't deserve all the blame for the precarious state of northeast Asian affairs, of course. That dubious honor must be shared, and owned, by the region's other two newish leaders: Shinzo Abe of Japan and Park Geun-hye of South Korea.

However powerful President Xi Jinping might have become, China's recent declaration of an air-defense identification zone does not add to its store of 'soft power.'

It was Tokyo's imprudent decision in September 2012 to buy the disputed islands from a private owner that truly incensed Beijing. The purchase may turn out to be the most expensive $26 million investment a government has ever made.

Abe is an unapologetic revisionist who remains intent on whitewashing Japan's World War II aggression, including the government's role in keeping military sex slaves; flexing Japan's muscles in Asia; and perhaps revising its pacifist constitution.

Park rarely misses a chance to hammer Japan about the sins of the past, though the points she scores at home come at the expense of a critical bilateral relationship.

Yet it is China's actions that most risk sparking conflict. They also contradict the spirit of reform and "opening up" repeatedly hailed at the Communist Party's recent plenum.

In addition to Japan and South Korea, China's air zone is sure to worry officials in Brunei, Indonesia, Malaysia, the Philippines and Taiwan, all of which are embroiled in territorial disputes with Beijing. A group of Chinese scholars want Beijing to claim Okinawa, too.

However powerful Xi has become, he's not adding to China's store of "soft power" with such behavior. The country took a big hit abroad for its chintzy $100,000 aid offering to the typhoon-devastated Philippines (international press coverage shamed Beijing into upping the donation to $1.6 million).

Its inflammatory new policy will only further alienate neighbors in a region it's seeking to woo away from the U.S.

Biden should take advantage of this dust-up to advance a U.S. "pivot" to Asia that until now has lacked both carrots and sticks.

In Tokyo, he should prod Abe to lead his people toward more enlightened engagement with Asia rather than follow his base nationalist instincts.

In Seoul, Biden should encourage Park to work with Abe, even if just on trade, the environment, North Korea and the challenges of governing a fast-aging population. The U.S. also should push the case for regular three-way summits between the leaders of Japan, China and Korea no matter what's afoot. Face-to-face meetings can create momentum toward deeper ties.

But Biden's sternest conversation should be with Communist leaders in Beijing. China says its global ambitions are peaceful and war isn't in the national DNA. Great.

It says it believes in mutual respect for other countries' domestic affairs. Fine.

It says it wants to "make Chinese culture go global." All sounds good. Beijing's recent actions, however, inspire little confidence in its words.

William Pesek is a Bloomberg View columnist in Tokyo. Contact him at: wpesek@bloomberg.net.

Swiss voters come to their senses amid Europe's soak-the-rich mood

Josef Joffe
Palo Alto California
BLOOMBERG

Some of my best friends are very rich — people with condos on Central Park West and tastefully refurbished *palazzi* in Italy.

The puzzle: Why do so many of them vote Democratic or praise the high-taxing European welfare state?

How rich? When one of them had an art lover on the phone, who was offering to pay $30 million for a famous painting, he refused. Frustrated, the would-be buyer groaned: "Look, man, I just more than doubled the going price for this piece, and you still won't take it. Why not?"

My friend's riposte: "Right now, I am the only man in the world who owns this unique painting. If I sold it to you, I would just be another guy with 30 million bucks."

This art-hoarding friend belongs to what we might call the Compassionate Croesus Crowd, the American version of la gauche caviar, the sturgeon-roe-gobbling left in France. In Paris, such people live in the 16th *arrondissement* (municipal subdivision). In New York, they dwell along the edges of Central Park — with extra homes in East Hampton, New York, and Vail, Colorado — or on Russian Hill in San Francisco.

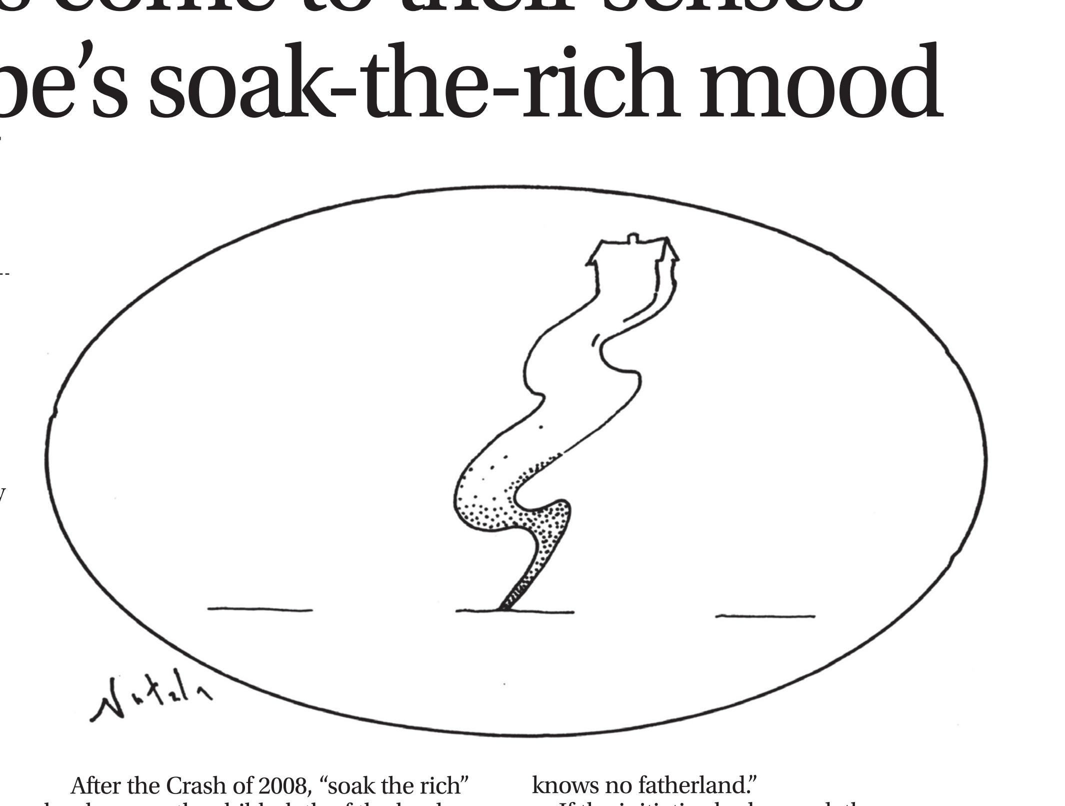
Karl Marx would stick them with "false consciousness." They go against their own class interest, which is to amass and to stash. Some rich people, such as Bill Gates, put their money where their heart is, and give away billions. But some of my American friends also donate to the Democratic Party and dream of a European tax-and-redistribute state.

Friendly souls will say: They want to give back. Cynics will argue: Their own riches are nicely sheltered from the taxman. Or because they feel guilty when they compare themselves with the toiling masses. Or because they fear the revolt of the underclass, recalling the burning U.S. cities of the 1960s and 1970s.

A sharp divide separates the two sides of the Atlantic. In the U.S., such benevolent conversations remain restricted to silver-laden dinner tables.

It is a lot easier to become super-rich in short order in the U.S. — and to keep the hoard from a grasping state. So, there is a bit of make-believe in these earnest disquisitions on part-and-share.

In Europe, the debate is for real. The postwar welfare state takes about half of gross domestic product — five points less in Germany, five points more in France.



After the Crash of 2008, "soak the rich" has become the shibboleth of the land. There is nary a political party that doesn't call for a special tax on the wealthy.

These levies will undoubtedly be blessed in parliament, even in Germany, which, after France, has the second-best Gini coefficient (the index measuring equality of income distribution after taxes and transfers) among Europe's large countries, according to Organization for Economic Cooperation and Development statistics.

The most striking test has been in Switzerland, whose Gini coefficient is just a little worse than Germany's.

What? This shiny tax haven — at least until the U.S. Internal Revenue Service broke down the doors? This low-tax paradise harboring some the largest multinationals in the world?

In March, a national referendum fired a first shot against executive pay. Shareholders will get to determine chief-executive compensation. Another initiative is on the table. It would grant a basic, unconditional income of 2,500 francs ($2,700) for each adult.

A third, the so-called 1:12 Initiative, sought to cap executive remuneration at 12 times the wage of the lowest-paid worker in the company.

On Nov. 24, the sensible Swiss — by almost two-thirds — voted to stop this foray. Multinationals such as Nestle SA and Novartis AG can now happily stay at home rather than having to relocate to the U.S. or U.K. How else would they compete for the most promising in the global market for talent? As Marx famously lectured, "Capital knows no fatherland."

If the initiative had passed, the companies might have remained in Switzerland, but their head honchos would have departed in short order.

One can't fail to be sympathetic to such populist revolts; after all, pay and bonuses, certainly outside Switzerland, have climbed to obscene levels. But distributive justice and economic efficiency make for an uneasy couple.

Leaving pay in place and taxing it away won't help, either, as long as brains can move across borders. Alas, the poor don't get richer by making the rich poorer.

The French have tried this, by imposing exorbitant payroll taxes on business and towering top rates on high earners, while letting wages rise above the growth in productivity. This has stuck them with some of the highest unit-labor costs in Europe. This munificence hasn't made the country as such any richer.

Italy comes in second; after France, it must bear the highest social charges as a fraction of pretax labor costs.

Both are the sick men of Europe — with low or no growth, and with double-digit unemployment rates that are twice as high as in Germany, which has held wages and taxes in check. So far.

Josef Joffe is editor of Die Zeit in Hamburg and a fellow at the Institute for International Studies and at the Hoover Institution, both at Stanford University. He is the author, most recently, of "The Myth of America's Decline." Email: joffe@zeit.de.

Why Chile prospers and Argentina flounders

Michael J. Boskin
Buenos Aires/Santiago

Economists often compare similar economies to isolate the impact of a particular difference. This approach provides a compelling picture of the role of specific factors in driving or undermining an economy's success.

For example, despite their common historical and cultural roots, North and South Korea are very different societies. The former has a considerably lower standard of living, owing to its communist government and centrally planned economy, which contrast sharply with South Korea's democratic government and mixed capitalist economy.

Germany's experience after World War II provides another telling example. When the Berlin Wall fell, barely two generations after the war ended, the standard of living in communist East Germany was just one-fifth the level attained in capitalist West Germany.

The same approach can be used to understand why Chile is prospering, while neighboring Argentina is floundering.

First, the similarities. Both countries are oriented along a north-south axis, and are characterized by varied terrain, long shorelines, and abundant agriculture, ranching, and vineyards.

Both won independence from Spain two centuries ago. Both have populations composed largely of people of European descent. Both have histories of military rule. And both have recently experienced political turmoil, including large — sometimes violent — public protests.

Moreover, Chile and Argentina are democracies that have been governed from the right and the left.

In Chile, a president can serve multiple terms, but not consecutively. So President Sebastian Piñera — a centrist leading a center-right coalition — cannot be a candidate for re-election next year, though he may run in 2018.

While Chile's governing coalition — especially Finance Minister Felipe Larrain — has done much to strengthen the country's macroeconomic performance, it has also struggled to find a strong presidential candidate; a scandal followed an intense internal battle for succession, with the center-right coalition forced to run its third-choice candidate. The leader of the center-left alliance, the Socialist Party's Michelle Bachelet (who was Piñera's predecessor), won the first round handily and is expected to be elected next year.

Meanwhile, despite having expanded her office's power, Argentine President Cristina Fernandez de Kirchner — who succeeded her late husband, Nestor Kirchner, in 2007 — is constitutionally prohibited from running for a third consecutive term. Her failure to win the two-thirds parliamentary majority needed to amend the constitution, together with opposition candidates' success in recent midterm elections, suggests that Argentina may well be set for a rightward shift in 2015.

Now, the differences. The two countries' economic policies diverge in important ways. Chile has usually followed economically sensible policies — sometimes innovatively so. For example, copper revenue, which comprises 13 percent of the budget, must be spent on the basis of a long-term, independently verified planning price, with excess revenue accumulated in a fund to be used when copper prices dip.

Furthermore, Chile's central bank has kept inflation low — it now stands at about 2 percent — and the budget is almost balanced. The country's pension system emphasizes private saving and individual responsibility. A bilateral free trade agreement has facilitated a surge in trade with the United States. Chile has participated in the negotiations for the Trans-Pacific Partnership (TPP) trade deal.

To be sure, Bachelet's proposals for higher corporate taxes, increased welfare spending, greater government control over pensions, and a re-examination of Chile's participation in the TPP threaten to reverse much of this progress. But if, once in office, she reverts to the more centrist policies of her previous term, Chile may maintain its economic momentum.

Argentina, by contrast, engages in serial, self-inflicted economic upheaval. With a population that is twice the size of Chile's, newly discovered energy deposits, and a vibrant capital city, Argentina has vast economic potential. Indeed, a century ago, it was one of the world's wealthiest countries, with a standard of living on par with that of the U.S. Today, however, Argentina's per capita income amounts to just 40 percent of America's, and is considerably lower than Chile's.

The spread between the official exchange rate and the black-market rate — the so-called *Dolar Blue* — now stands at 60 percent. Unsurprisingly, virtually every retailer in Buenos Aires quotes a dollar price and a peso price. This can be explained partly by high inflation, which independent analysts put at roughly 25 percent — more than double the official estimate of 10 percent.

Since Kirchner replaced the lead inflation statistician at the National Statistics Institute in 2007, Argentina's official inflation figures have been conspicuously lower than other estimates. (Chile's inflation figures have been criticized, too, though to a much smaller extent, and Chile's state statistics institute is far more independent of the government than Argentina's.)

Fernandez's government bullies and nationalizes businesses, and pressures the central bank to use international reserves for debt payments. And Argentina's major trade agreement, Mercosur, has fallen far short of its potential. Over the next five years, the International Monetary Fund expects Argentina to experience weaker growth, higher inflation and more unemployment than Chile.

Fortunately voters are increasingly turning against Fernandez's government.

In August, opposition candidates like Sergio Massa and Mauricio Macri attracted substantial electoral support with their business-friendly, anti-inflation campaigns, making them likely presidential candidates in 2015.

Even if Fernandez does not cause too much damage in the interim, her successor will have to restore Argentina's credibility at home and abroad, in order to prevent capital flight.

Can an Argentine president promote disinflation and retain voter support during a period of slower growth, or even recession? It happened in the U.S.; President Ronald Reagan supported U.S. Federal Reserve Chairman Paul Volcker's disinflation, despite a deep recession, a temporary spike in unemployment, and midterm election losses.

The economy soon rebounded, and Reagan was re-elected.

Price stability enabled a quarter-century of strong growth and low unemployment, interrupted by two brief, mild recessions — the best macroeconomic performance in American history.

One hopes that Argentina will learn from its Western neighbor — and that a Bachelet administration in Chile will look across the Andes, recognize where its proposals risk taking the country, and change course before it is too late.

Michael J. Boskin, professor of economics at Stanford University and senior fellow at the Hoover Institution, was chairman of George H. W. Bush's Council of Economic Advisers from 1989 to 1993.

U.S. unprepared to limit swings in food prices

Kevin P. Gallagher
Washington
THE GLOBALIST

The United States has left the world's poor at the global trade negotiating table.

After more than a decade in gridlock, world trade negotiators had high hopes of closing a final deal at the World Trade Organization (WTO), which is to hold a ministerial in Bali, Indonesia, Dec. 6-13.

But the U.S. is not prepared to let developing countries protect their poor from the harmful swings in world food prices. That is all the more unfortunate as these price swings are increasingly caused by U.S. policy in the first place.

Now, negotiations have collapsed. This is all the more regrettable not only because the WTO serves as a global rules-based system where nation-states monitor each other's policies to make sure they are not too trade-distorting.

More specifically, the WTO can also be praised for helping to prevent nations from putting up major protectionist barriers in the wake of the global financial crisis.

The new director general of the WTO, Brazil's Roberto Azevedo, was trying to seek this momentum by moving forward to declare a pivotal victory for the WTO. His proposal had two main components: First, agree on a deal to streamline global customs rules; and second, allow developing countries to buffer their poor from volatile food prices until a more comprehensive deal on food and agriculture could be reached in a future round of negotiation.

The reasoning behind this package was sound. Food price volatility has wracked the world's poor in recent years.

A global food price spike in 2007-08 triggered the Arab Spring movement and took a bite out of the food budgets of the world's poorest urban consumers. Low prices a decade earlier had squeezed many small farmers off the land who today comprise much of the urban poor.

Much of this upward pressure on food prices can be traced back to the U.S. The U.S. is home to massive subsidies to its agricultural sector, the World Bank estimates that these cost poor countries $12 billion on an annual basis.

What's more, the U.S. financial industry "financialized" food by creating commodity index funds that speculators have feasted on since the global financial crisis. The Dodd-Frank bill the financial reform legislation in the U.S. was to put limits on such speculation.

However, big U.S. agribusinesses are trying to see to it that such limits are dropped from the rule-making.

So it does not come as a real surprise that it was the U.S. that rejected a proposal by India and other countries to buffer their poor farmers and consumers from food price swings. The U.S. government claimed that measures to protect farmers and consumers from food price volatility were a violation of WTO rules.

Instead, the U.S. offered a peace clause whereby the U.S. and other nations would not file claims against poor countries for these measures for three to four years.

The U.S. claimed that allowing India to support farmers and consumers who live on less than $1.25 a day from food price volatility would distort global markets. That claim is jarring to the world's poor.

Given that it takes three to four years to settle a dispute in the WTO, a three-to-four-year grace period adds little benefit. Moreover, agreeing to a peace clause would essentially make poor countries admit that their measures are in violation of WTO rules, which shouldn't be the case.

The United Nations' Special Rapporteur for food has just noted how the WTO is incompatible with food security measures. It is a scandal that the world's countries had a golden opportunity to fix a fundamental distortion in the global trading system that causes impoverishment — and that the U.S. has flatly blocked it at the WTO.

By dumping the WTO unless it accedes in full to U.S. demands, the U.S., despite all its rhetoric in favor of multilateral approaches, makes plain its intention to focus on trade treaties like the Trans-Pacific Partnership.

In such deals structured by the U.S., food is largely off the negotiating table. This further underscores that regional trade deals distort the world economy and put developing countries at an unfair negotiating disadvantage relative to the U.S.

The WTO, with its one-country-one vote negotiating structure, can yield far more equal outcomes. There will be a last chance to salvage global trade talks in Bali. The U.S. should do right by the world's poor and grant them food security.

Kevin P. Gallagher, a regular contributor to The Globalist, is a professor at Boston University and author of the new book "The Clash of Globalizations: Essays on Trade and Development Policy."