

Weekly Commentary 20 – May 2023

G7 and the Global Economic Order

Hiroshima is where leaders of the G7 countries are meeting, as this blog is written. They have traditionally been leaders of the world economy. The world used to look for some grand plan emerging from this leadership group. This time, however, there is no such thing.

Even before the meeting is over, the news emerging from the conference is that it has already provoked reactions from both Russia and China. In short, there is only discord. G7 is the manifestation of the American empire that is trying to maintain its pre-eminence in the global economy even as the alternative economic bloc, BRICS, led by China and Russia, is gaining momentum as a viable alternative to leadership for most of the countries not in G7 or BRICS. As such, the sense is that the rivalry is getting intense.

Obviously, the statements coming out of this G7 gathering, at a time when BRICS is gaining traction as a competitor, can be viewed as being self-interested, a defense of the turf that they would consider BRICS to be encroaching on.

The fact of the matter is that the unipolar world in which G7 has held sway is over. The multipolar world has emerged and there is nothing that these western nations can do to reverse that.

The G7 leaders doubled down on condemning Russia, when after 15 months of conflict, the war in Ukraine indicates that they have underestimated the Russian determination not to permit an extension of NATO to its western border. Is that so difficult for G7 leaders to understand? And this is after they have made many faithless promises to successive generations of leaders in Moscow that there will not be eastward expansion of NATO. That has now provoked a war in Ukraine. And that war is being lost, in spite of continuing propaganda that Ukraine is holding its own.

On 20th May, the Russian Ministry of Defence confirmed the fall of Bakhmut, a salt mining town that was the center of fighting between the two sides, for the last 224 days. Its capture is important symbolically because the Ukrainians have staked so much on its defence – saying all this time, that they will never allow it to be captured by the Russians. And the west has poured huge quantities of weapons, all touted to be “game-changers”, into the battle to ensure that the Ukrainians will defeat the Russians. Rather than ensuring that outcome, all

that has happened is that the demonstration of resolve has turned Bakhmut into a WW2 “Bastogne” in which the American army held out against the German Wehrmacht, during the Battle of the Bulge in 1944. Winning for either side in Bakhmut was regarded as vital for legitimacy of its political position. And now, Ukraine has failed.

This failure is not just a defeat on the battlefield. The constantly broadcasted fake narrative that Ukraine was winning will be called into question. It will inevitably lead to the various electorates in all the G7 countries to re-examine the purpose of the war in Ukraine. “Why are we being lied to, again?” will be a new demand for the truth. And if that emerges, it will also call into question the claim that the collective west is righteous and Russia is evil; that “we” ie the west, are the good guys and Russia the bad. It will evolve into a Vietnam era searching of souls. This is exactly what the G7 don’t want to see happen. When it inevitably does, the world order will change.

Take a read of the following article in the New York Times, published just a few days before the fall of Bakhmut. It portrays the Ukrainians as making headway in holding off the Russians. And it took all of three days for the NYT to be proven completely wrong. What an embarrassment!

Gains Near Bakhmut Raise Ukraine’s Hopes of a Turning Tide

The advances have been small, and Russians still hold most of the city, but Ukrainians say they see a meaningful shift in momentum.

By Marc Santora
May 17, 2023

Russian forces spent nearly a year carving a path of devastation and death in their bid to surround the city of Bakhmut in eastern Ukraine, and by March it seemed they were close to succeeding.

“The pincers are closing,” said Yevgeny Prigozhin, the founder of the Wagner mercenary group that spearheaded Russia’s bloody drive.

He was wrong. The pincers never closed, and now Ukrainian forces have pried them farther open, taking back territory north and south of the ruined city in a few days that it took the Russians many weeks to capture.

Moscow’s troops still hold most of Bakhmut itself, Ukraine’s recent gains around the city are not large, and there is no guarantee that they will last. But for the first time in months, Ukrainian soldiers are on the offensive and the momentum in the longest and bloodiest battle of the war appears to have shifted their way — at least for now.

Continued Ukrainian advances would reverse the situation of a few months ago, putting the Russians inside Bakhmut at risk of being surrounded and trapped, and would demonstrate that the deep, fortified lines the Russians have built across Ukraine can be breached. Success around Bakhmut

would also provide a major morale boost for Ukraine and a serious blow to Russia, denying it the only military achievement that for months had seemed within its grasp.

The possible reversal of fortunes comes as Ukraine is preparing to mount a broader counteroffensive, aiming for a dramatic breakthrough in a war that has settled into a grueling slugfest, with much blood spilled but little ground gained. While the dynamics around Bakhmut are somewhat specific to that battle, Ukrainian commanders say they hope to build on the lessons learned there when they try to attack in other places along the 600-mile front line.

“When you retreat it is very difficult to stop,” said Col. Andriy Biletsky, the commander of Ukraine’s 3rd Assault Brigade, whose soldiers made the first breakthrough of the Russian lines last week. “When you want to advance, it is very difficult to start.”

He cautioned that he was waiting to see if “there is a chain of five, six, seven victories” before assessing the state of the fighting, but he was hopeful.

“We can say that the phase of blind defense near Bakhmut has passed and now at least there will be movements of both sides,” he said.

“Wagner’s men have entered Bakhmut like rats into a mousetrap,” the commander of all Ukrainian ground forces, Col. Gen. Oleksandr Syrskyi, told soldiers during a visit to the front on Tuesday.

General Syrskyi and other Ukrainian commanders cautioned that the fighting was still fierce and a desperate battle was still being waged within Bakhmut, where Russian forces are trying to drive the last Ukrainian defenders from the ruins of the city. Five months after first fighting their way into the city, the Russians hold about 90 percent of it.

“The enemy is advancing somewhat in Bakhmut itself, completely destroying the city with artillery,” Hanna Mailar, a Ukrainian deputy defense minister, said Tuesday night.

Ukrainian commanders want to keep a large Russian force tied down in and around Bakhmut, preventing redeployment to other areas that could soon come under attack. They said Russia was already sending reinforcements to the Bakhmut area, including tank units and fresh fighters, to try to halt Ukrainian advances.

Still, Ukrainian commanders said on Tuesday that their soldiers were continuing to move forward.

Maj. Oleksandr Pantsyrny, the commander of 24th separate assault battalion “Aidar,” said that Ukraine has “regained initiative on the flanks, to the north and south of the city.”

Konrad Muzyka, a defense analyst for Rochan Consulting, said the recent Ukrainian gains exposed “fundamental Russian weaknesses: a lack of coordination between regular Russian formations and Wagner units, poor communication and morale.”

For months, Ukraine has insisted that before starting its counteroffensive, it needs a major influx of tanks, infantry fighting vehicles and other weapons from its allies. Mr. Muzyka said it was noteworthy that Ukrainian gains around Bakhmut were achieved “without using major Western-supplied platforms, such as Bradley I.F.V. or Leopard tanks.”

Ukraine’s troops were able to drive forward about two kilometers in some directions on Sunday and Monday, Col. Serhiy Cherevatyi, a spokesman for the Ukrainian forces fighting in the east, said in an appearance on national television.

Without going into detail, he said the forward march had been uneven, with pitched battles being fought over areas about the size of three football fields in some locations. He also warned that Russian forces were still trying to mount counterattacks in places.

While his claims could not be independently verified, Russian military bloggers also have noted Ukrainian gains around Bakhmut over the past week.

Southwest of Bakhmut, Ukrainian soldiers and commanders have reported an advance through a pocket of forests near the village of Ivanivske, and they appear to be moving in the direction of Klishchiivka, a small village that Wagner mercenaries claimed on Jan. 19 after weeks of combat.

The village sits on high ground, and whichever army controls it has a commanding position overlooking important roadways to Bakhmut.

Northwest of the city, the armies appear to be fighting over control of high ground around the Berkhiv Reservoir. Without mentioning a retreat, the Russian Ministry of Defense said over the weekend that its forces were regrouping around the reservoir to “increase the strength of the line of defense.”

Colonel Cherevatyi said there were 36 different “clashes” between the opposing armies around the city over the past two days and cautioned that it was a fluid and dynamic situation.

Ukraine’s staunch defense of Bakhmut, a small city of limited strategic value, has come at a high cost, with some of its most experienced soldiers killed in action there over the past year. But it has stopped the Russians from moving on to besiege the larger cities of Kramatorsk and Sloviansk.

Ukrainian officials say it has also played a critical role in weakening the Russian military. As long as the Russian losses were greater than Ukrainian losses, officials in Kyiv have maintained, then the fight made sense from the grim perspective of battlefield math.

Now that the Ukrainians are no longer simply absorbing blows but moving forward, Ukrainian commanders and officials hope the calculus will change again and it will be Russia that needs to decide what cost it is willing to pay to hold onto a city that is being wiped off the map day by day.

Once a city of about 70,000 people in the Donetsk region, known for its sparkling wine and salt mines, Bakhmut has become emblematic of the savagery of this war.

*Ukrainian military officials emphasized that what was happening around Bakhmut is still now only a partial **success**.*

The situation inside the city has grown so dire, Ukrainian soldiers said, that their commanders are only sending in volunteers.

“If you enter Bakhmut, you must know you might not make it out,” said one soldier. Bone-tired and bleary-eyed, he did not offer his name, as he sat under a bus stop near the battered city.

His comrade said, “It’s insane to be in Bakhmut now. The shelling never stops.”

Well, as it turns out, nothing in red (highlighted by yours truly) happened. In just three days, the story has been proven to be a bunch of lies. There was no pincer movement north and south of Bakhmut. Only the NYT was stupid enough to believe in fairy tales and repeat the

BS by the Ukrainians. Three days. That was just three days ago, when they broadcasted that propaganda.

Now the Russians have come up with the final numbers for the battle and we can take it as propaganda from the other side. But at least they have won the right to have the final say on the battle:

Wagner Captured Bakhmut 2023.05.20

MAIN FORCES:
Wagner

MAIN DEFEATED FORCES:
Brigades: 45, 43, 26, 24, 28, 30, 62, 53, 56, 57, 60, 63, 67, 92, 93, 5, 1, 101, 109, 112, 116, 122, 125, 127, 119, 241, 93, 77, 80, 46,

UNOFFICIAL FINISH DATE:
May 20th, 2023

OFFICIAL FINISH DATE:
May 21th, 2023

THE BEGINNING OF OPERATION:
October 2022

DAYS OF BATTLE:
224

UKRAINIAN LOSSES KIA:
39000

UKRAINIAN KILLED:
23000

UKRAINIAN ARMORED VEHICLES LOSSES:
7.8\$ Billions

UKRAINIAN DRONES LOSSES:
2700

UKRAINIAN PLANES LOSSES:
23

Whoever is right in the propaganda war is not important. That battle is over, and we should expect the Russians to move forward in their “special military operation”. Zelensky, meeting the press in Japan, seems worried.

Hence, we see the sense of urgency in creating the message over the first two days of G7 meetings that Russia’s action in Ukraine should not be tolerated by the rest of the world. Of course, that is only one side of the story. What about, on the other side, Russia’s security concerns?

The fall of Bakhmut comes at an inconvenient time, because the fact that it goes against all that cocksure optimism in the western narrative, even as recently as last week in the NYT, has made the collective west look bad. Caught lying to their own electorates again, as in Vietnam, Iraq and Afghanistan, there will soon be the sense of distrust, of repeated

government deception and a further weakening of public attitudes on western political leadership.

As I wrote in my Weekly Commentary 9, some ten weeks ago, I had pointed out the geopolitical importance of the Battle of Bakhmut. Not that the town is of any great strategic importance, but only because both sides have staked everything on it. Zelensky has even presented an Ukrainian flag with the signatures of some of Bakhmut's defenders to the US congress, symbolising defiance to Russia and an undefeatable will to triumph. The west lapped it up. Good and evil easily identified. So even if you don't trust the Russian Ministry of Defence, you can trust The Hill, which will clearly not publish the following story without understanding the impact of its dissemination in its pages:

Wagner Group claims it seized Bakhmut with help from Russian troops

BY JULIA SHAPERO - 05/20/23 7:21 PM ET

Russia's Defense Ministry said on Saturday that the Wagner Group has seized Bakhmut with assistance from Russian troops, after a protracted monthslong battle over the eastern Ukrainian city.

"As a result of offensive actions by Wagner assault units, supported by artillery and aviation of the Yug Group of Forces, the liberation of Artyomovsk has been completed," the ministry said in a post on Telegram, using the Soviet-era name for Bakhmut.

Wagner Group founder Yevgeny Prigozhin had claimed in a video earlier in the day that his private mercenary company had "completely taken" the city.

"Today, at 12 noon, Bakhmut was completely taken," Prigozhin said, according to Reuters. "We completely took the whole city, from house to house."

Russian President Vladimir Putin congratulated the Wagner Group and Russian forces on the "completion of the operation to liberate" Bakhmut, according to a statement from the Kremlin reported by Russian state news agency TASS.

However, Serhiy Cherevatyi, a spokesman for Ukraine's eastern command, denied Prigozhin's claims earlier in the day, telling The Associated Press that it was "not true" and "our units are fighting in Bakhmut."

Earlier this month, Prigozhin said that his mercenaries would withdraw from the city, claiming that they were "doomed to senseless death" amid a lack of ammunition from Russia's Defense Ministry.

"By not giving us shells, you are not depriving us of victory, you are depriving the people of Russia of victory," he said at the time.

Prigozhin reversed course days later, saying the Wagner Group had been "promised as much ammunition and armament as we need to keep going."

So, no. The inconvenient timing of the final defeat of the Ukrainian armed forces in Bakhmut makes the G7 declarations on Russian aggression look a little forlorn in its helplessness. After all, US\$150 billion of the most advanced NATO weapons – much heralded “game changers” - have flowed into Kyiv, specifically to assist the Ukrainians to avoid exactly such a loss. First it was anti-tank and anti-aircraft weapons like Stinger and Javelin missiles (which actually helped to shape the war into the attrition faceoff it has become since “big arrow” offensives like in WW2 have become less feasible), artillery systems such as HIMARS, and more recently, western tanks and armoured vehicles. Next, it will be F-16 fighter jets. None of these have turned the tide, when each time something new was introduced, they have always been touted to be a “game changer” and would win the war for Ukraine. Nope, none of those weapons systems did. The capture of Bakhmut tells us that Russia, standing alone against 28 countries with 21 times the GDP, seems to be more than a match for all of them combined. It is truly embarrassing for the G7 and its “coalition of the righteous”.

The G7 in further statements, also addressed the so-called “China threat”. They took aim at some of China’s policies and called it “trade weaponization”, or “economic bullying”. In their statement, they said, “we will work together to ensure that attempts to weaponize economic dependencies by forcing G7 members and our partners, including small economies, to comply and conform will fail and face consequences.” It is true that in recent years, China had pressured multinational companies to sever ties with Lithuania or face exclusion from the Chinese market. That was in response to Lithuania allowing the opening of a de facto embassy by Taiwan (which was prompted by Lithuania trying to curry favour with the United States).

Nevertheless, the statement above was also accompanied by a more friendly one, in which it is stated, “we stand prepared to build constructive and stable relations with China, recognizing the importance of engaging candidly with and expressing our concerns directly to China. Our policy approaches are not designed to harm China, nor do we seek to thwart China’s economic progress and development,” adding that the G-7 countries are not decoupling or turning inwards.

Really? Then why the Chips War, in which the US with Japan, S Korea and the Netherlands ganged up to stop selling semiconductors to China? When that happened, the stated objective was to hold back China’s technological progress. The world heard it loud and clear. So did China. To say that G7 or American policies are not to intended to harm China is just a crock of horse-shit. Why not just call a spade a spade? No hypocrisy, please...

Well, this seems like a case of “we can do anything we want, but you cannot do anything to reciprocate.” If one considers the sanctions against all those countries with policies which

America does not find agreeable, aren't all of those sanctions "economic coercion"? This is basically the attitude of a hegemon which wants the world to stay that way. Hey, there's nothing wrong with that, but let's call hypocrisy what it really is, and not insult people's intelligence by saying things that are totally BS.

In any case, who said that there is fairness in geopolitics? It is naïve to think that the collective west will be fair to its major competitors in the world, including Russia for stating its position on NATO expansion and China for using exactly the same economic coercion that has become standard US policy against countries it deems to be acting against its interest.

The fact of the matter is that the G7 summit in Hiroshima is another sign of the times. That there are now two economic blocs in the world, and each is trying to better the other one. There is an article by Niall Ferguson, a Stanford historian who wrote the following opinion for Bloomberg:

When You're in a Cold War, Play for Time

"De-risking" is Washington's new word for detente. It's the right strategy as China's economy slows and its social problems grow.

By

Niall Ferguson

2023 May 21

Niall Ferguson is a Bloomberg Opinion columnist. He is the Milbank Family Senior Fellow at the Hoover Institution at Stanford University and the author, most recently, of "Doom: The Politics of Catastrophe." He is the founder of Greenmantle, an advisory firm, FourWinds Research, Hunting Tower, a venture capital partnership, and the filmmaker Chimerica Media. (Highlights in red are mine)

Detente is in the air.

On May 8, US Ambassador to China Nicholas Burns and Chinese Foreign Minister Qin Gang met in Beijing — the first significant encounter since a Chinese spy balloon was spotted over Montana. True, the Chinese side couldn't resist accusing the American side of "erroneous words and deeds," but it was better than a frosty silence. Two days later, President Joe Biden's national security adviser, Jake Sullivan, sat down in Vienna for lengthy discussions with Wang Yi, Qin's boss. The two men weren't exactly exchanging Maotai toasts; but at least they didn't come to blows over Taiwan.

Even Sullivan's important speech at the Brookings Institution last month was obviously intended to make Cold War II a bit less chilly. The recent past, in Sullivan's telling, was a tale of unintended consequences. American believers in free markets and globalization had admitted China to the World Trade Organization, not realizing that China would continue to subsidize key industries. "America didn't just lose manufacturing," he said. "We eroded our competitiveness in critical technologies that would define the future."

*However, Sullivan explained, **all this is now being addressed by the Biden administration's new "foreign policy for the middle class."** The US now has an industrial strategy of its own, in the form of public investment to encourage the domestic production of semiconductors and of critical minerals*

necessary for the production of electric vehicles. America's technological lead over China is going to reside in "a small yard [with a] high fence." Money quote: "We are for de-risking and diversifying, not decoupling. ... *We are not looking for confrontation or conflict. We're looking to manage competition responsibly and seeking to work together with China where we can.*"

Detente didn't end Cold War I in the 1970s; it just made it less fractious, reducing the risk of World War III. The same is true in today's cold war. To get a sense of how cold this war still is, despite the shift from "decoupling" to the less drastic "de-risking," take a look at the Chinese version of the recent past. The Chinese Foreign Ministry's essay, "US Hegemony and Its Perils," was published just three months ago. It is altogether different in tone.

"Since becoming the world's most powerful country after the two world wars and the Cold War," this tract begins, "the United States has acted more boldly to interfere in the internal affairs of other countries, pursue, maintain and abuse hegemony, advance subversion and infiltration, and willfully wage wars, bringing harm to the international community."

The United States has developed a hegemonic playbook to stage "color revolutions," instigate regional disputes, and even directly launch wars under the guise of promoting democracy, freedom and human rights. Clinging to the Cold War mentality, the United States has ramped up bloc politics and stoked conflict and confrontation. It has overstretched the concept of national security, abused export controls and forced unilateral sanctions upon others. It has taken a selective approach to international law and rules, utilizing or discarding them as it sees fit, and has sought to impose rules that serve its own interests in the name of upholding a "rules-based international order."

Wait, did the Chinese government hire Noam Chomsky?

The striking thing about the tone of the Chinese document is the insecurity it betrays. The irony is that, if the Chinese were serious students of Marxism-Leninism, they would be far less impressed by US hegemony and far more optimistic about its imminent collapse under the weight of its own internal contradictions.

To ditch their inferiority complex, Qin Gang's propaganda people should read Peter Turchin's extraordinary new book, *End Times: Elites, Counter-Elites and the Path of Political Disintegration*. Turchin is a practitioner of "cliodynamics," an ambitious attempt to apply complexity theory and much else to human history. *End Times* is the culmination of many years of highly original and innovative work. The only disappointment is that its conclusion has a faintly Marxian whiff:

When a state, such as the United States, has stagnating or declining real wages, a growing gap between rich and poor, overproduction of young graduates with advanced degrees, declining public trust, and exploding public debt, these seemingly disparate social indicators are actually related to each other dynamically. Historically, such developments have served as leading indicators of looming political instability. In the United States, all of these factors started to take an ominous turn in the 1970s. The data pointed to the years around 2020 when the confluence of these trends was expected to trigger a spike in political instability. And here we are.

The problem, Turchin argues, is that "the American ruling class" and "governing elites" have alienated "large swaths of degree holders," who, "frustrated in their quest for elite positions ... dream of overthrowing the existing regime." It is all quite persuasive until you realize that the people most attracted to Tucker Carlson's rants against the ruling elite are precisely Americans without

degrees. College turns people into progressives, or at least people who do not dare question progressive ideology.

Turchin has quite a lot to say about the crisis of Qing China that produced the Taiping Rebellion (1850-1864) — perhaps the most horrific example of the kind of revolution that interests him. He does not consider the possibility that contemporary China might be as good a case for testing his theory as the US.

*This may strike you as counterintuitive. If you are not following China closely, you probably have the vague idea that, now the Red Emperor has abandoned his “zero Covid” policy, everything is going swimmingly. But that is to underestimate the Chinese Communist Party’s mounting problems. In truth, with its dire demographic prospects and its over-leveraged and depressed real-estate sector, the Chinese economy seems destined for a 20-year growth rate significantly lower than this year’s “around 5%” target. **I stand by my 2019 bet with Justin Yifu Lin that China will not overtake the US in terms of current dollar gross domestic product by 2039. The Economist now agrees that we are approaching “Peak China,” while the US economy is “riding high.”***

It is true that at the last Politburo meeting, on April 28, policymakers concluded that economic growth in the first quarter of this year was “better than expected” and that “market demand [had] gradually recovered.” Domestic travel has indeed revived: Volumes of passengers in cars, trains and planes are back at pre-Covid levels. Data from China’s five-day Labor Day holiday earlier this month point to a surge in travel and consumption. Domestic travel volumes during that period were 19% higher than in 2019, before the pandemic.

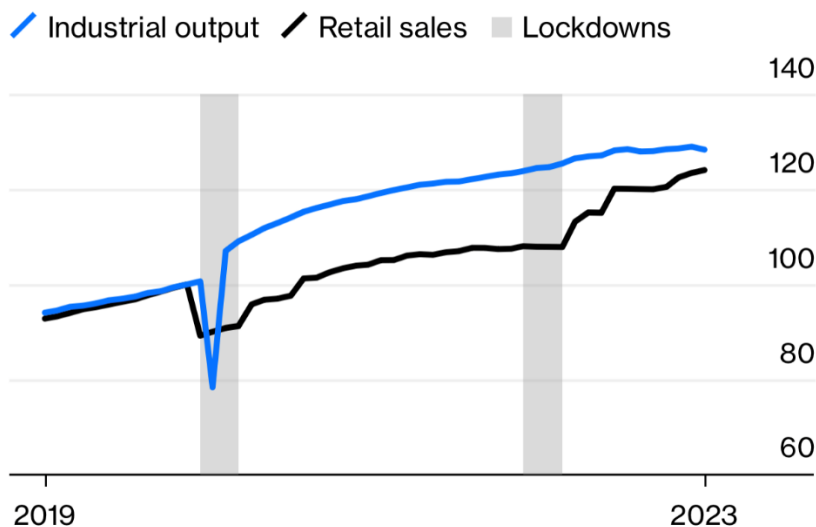
However, so-called revenge spending seems likely to fizzle out in the second half of 2023. Chinese credit growth showed signs of softening in March. And there will be no fiscal or monetary stimulus on the scale we saw after the 2008-09 Western financial crisis. Given the huge amounts of local government debt, much of it accrued to build towers for nobody, Chinese public finances simply could not stand it. The public debt-to-GDP ratio is projected by the International Monetary Fund to exceed 100% in 2026. Including local government borrowing, the IMF estimates that the real figure is already above 110%, while last year’s “augmented” budget deficit was a huge 17% of GDP.

True, one sector that is booming is EVs. On the roads in Beijing and Shanghai, it looks as if almost half the cars are now battery propelled. Domestic players such as SAIC, BYD and Li Auto are locked in mortal combat with one other and with Tesla, which has been forced to slash its prices to compete. Western manufacturers of conventional or hybrid vehicles are dead in the water. At the recent Shanghai Auto Show, the crowds were in the Chinese EV showrooms, while foreign showrooms looked empty. With the domestic market saturated, Chinese EVs are also flooding the world auto market. The dollar value of Chinese car exports has increased nearly fivefold in just two years.

*China’s Post-Covid Recovery Slows
Industrial output declined from March, while retail sales growth slackened*

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Source: Bloomberg Economics calculations from National Bureau of Statistics data
Shows an index with Dec. 2019 = 100. Retail sales data is seasonally adjusted

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Shows an index with Dec. 2019 = 100. Retail sales data is seasonally adjusted

Yet recent data indicate significant headwinds for Chinese exporters. On a monthly basis, exports fell 6.4% in April. Recent purchasing managers' indexes paint a similarly bearish picture about manufacturing. The Caixin private PMI for manufacturing dropped from 50 in March to 49.5 in April. The official manufacturing subindex for new export orders fell sharply to 47.6 in April, down from 50.4 in March.

This slowdown is making itself felt in the Chinese labor market. According to the Leading Index of Manufacturing Prosperity, produced by Shanghai Jiao Tong University, manufacturing employment and wages improved slightly in March, up from 26.1 in February to 35.9 in March, though the report remains "extremely unoptimistic" in terms of future direction. (A reading over 50 means better than the historical average while a reading below 50 means worse than the historical average.) The wage sub-index was also in the "extremely unoptimistic" range, though rising from 16.5 in February to 29.0 in March.

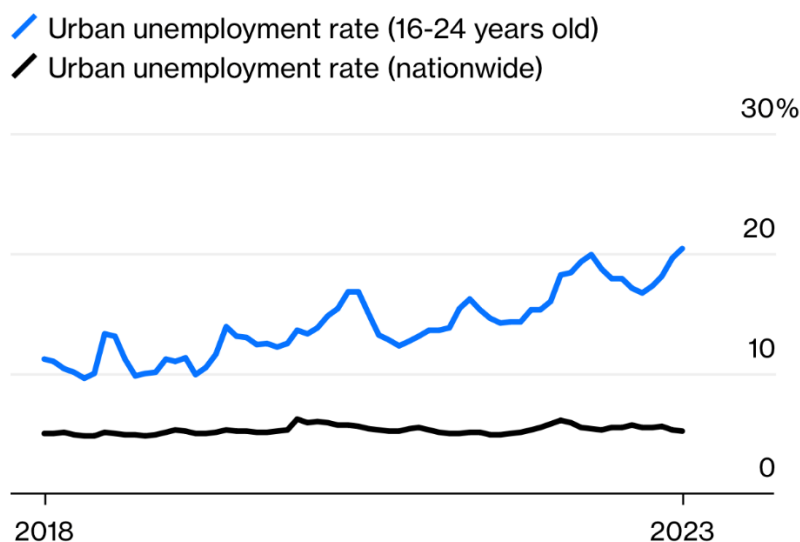
Another significant sign of the times is worsening inequality — despite all Xi's talk of "common prosperity." According to the National Bureau of Statistics of China, in 2022 the average wage in the highest-paying private-sector jobs was 2.91 times that of the average wage in the lowest-paying private-sector jobs, up from a 2.26 multiple in 2019.

But the CCP's biggest headache is the lack of employment opportunities for young people. The official youth unemployment rate for 16- to 24-year-olds is now 20.4%, up significantly from the pre-Covid average of around 11%. Around 11.6 million college students are expected to graduate over this summer — a historic high. According to the Chinese online recruitment platform Zhaopin, only half (50.4%) of these new graduates have obtained job offers.

Graduating to Unemployment
China's youth jobless rate topped an all-time high in April

Graduating to Unemployment

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Source: National Bureau of Statistics

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The concept of tang ping (“lying flat”) — opting out of the workaholic habits of older generations — is widely associated with the gloomy outlook of China’s Gen Z. This has important implications. China has a history of disaffected, over-educated youths launching disruptive mass protests — not only the Taiping Rebellion but also the 1919 May Fourth Movement, the 1989 Tiananmen protests and, most recently, the November 2022 Covid protests. Paging Peter Turchin! “A growing gap between rich and poor, overproduction of young graduates with advanced degrees, declining public trust, and exploding public debt.” That sounds a lot like China in 2023.

In the mid-1970s, when detente seemed to be decaying as evidence mounted of Soviet bad faith in the arms race and bad behavior in what was then called the Third World, Ronald Reagan and a new generation of neoconservatives began equating it with “appeasement.” This made Henry Kissinger, detente’s architect, almost as unpopular on the right as he already was on the left.

Yet Reagan and the neocons misunderstood (or misrepresented) detente. It was not born of any faith in the good intentions of the Soviets. Rather, it was motivated by a desire, first, to engage with Moscow in the belief that the more engagement there was, the less likely another Cuban Missile Crisis would become; and second, to play for time, in the hope that the US would sooner or later emerge from stagflation while the Soviet economic outlook would only deteriorate.

It worked. America put Vietnam behind it, focused on Moore’s Law, invented the personal computer, and paved the way to the internet. The Soviets embroiled themselves in worse and worse conflicts — Angola, Ethiopia, Afghanistan — and slid into complete economic stagnation. Finally, the Soviet system succumbed to a different kind of crisis from the type that interests Turchin: a crisis of legitimacy, in which more and more people simply ceased to believe in the Soviet system and the ideology on which it was based.

This was what George Kennan had always foreseen as the ultimate victory of containment. In the summer of 1947, Kennan published his anonymous essay in Foreign Affairs, "The Sources of Soviet Conduct." In a startling passage, he likened the seeming power of the Soviet Union to that of the grand merchant family in Thomas Mann's novel Buddenbrooks:

Observing that human institutions often show the greatest outward brilliance at a moment when inner decay is in reality farthest advanced, [Mann] compared the Buddenbrook family, in the days of its greatest glamour, to one of those stars whose light shines most brightly on this world when in reality it has long since ceased to exist. And who can say with assurance that the strong light still cast by the Kremlin on the dissatisfied peoples of the western world is not the powerful afterglow of a constellation which is in actuality on the wane? ... [T]he possibility remains ... that Soviet power ... bears within it the seeds of its own decay, and that the sprouting of these seeds is well advanced.

*I often think of that passage when I visit shiny Shanghai. And it makes me wish Jake Sullivan the best of luck with his version of detente, although I frankly doubt it will do much for the American middle class. **There is some chance that Peter Turchin is right and that, in this Cold War, the crisis of legitimacy will befall the democracy, not the one-party state. On balance, however, I think the Kennan principle still applies. The seeds of decay lie within every political system, of course. But they sprout faster in the absence of freedom. Just play for time, America. It's probably on your side.***

The above opinion reflects what is really behind G7 thinking, in spite of the diplomatic niceties in their official statements. Niall Ferguson is an unofficial spokesman for the collective west, and it reflects an arrogance that the western system is better and that China is not capable of improving on their own systems to make things better for their own country. So when I read the Ferguson article in the context of the G7 statements, I am unimpressed with the official line – that the G7 is not working in concert to contain China. If you ask me, some of the more aggressive G7 nations (US? UK?) are all for hemming China in, to keep the west on top, but probably the more conciliatory members (France? Germany? Italy?) insisted on a more pacifist public statement. And we got what we see...

I am not citing the Ferguson article, just to say that it is a reflection of the intelligentsia in the west regarding their attitude towards the rise of China. They would like it to falter and fail, as Ferguson stated in his final sentence: "Just play for time, America. It's probably on your side." To be honest, I think the "playing for time" applies more to China than to America. Consider the following article below, written about the recent debt crisis in America. America's economy is in deep shit, and if China plays for time, it will probably be on China's side.

Visualizing The Rise Of America's Debt Ceiling

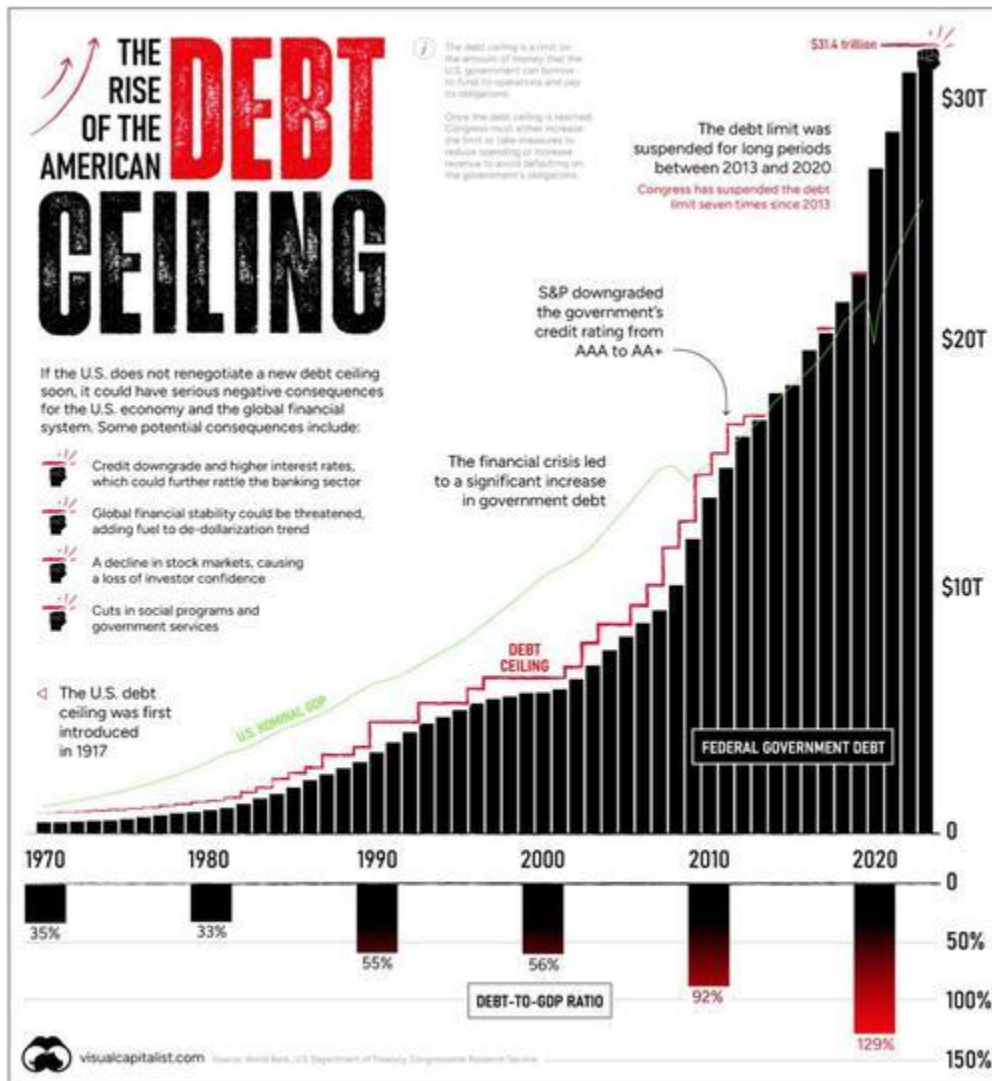
BY TYLER DURDEN

THURSDAY, MAY 18, 2023 - 11:20 AM

Every few years the debt ceiling standoff puts the credit of the U.S. at risk.

In January, the **\$31.4 trillion** debt limit - the amount of debt the U.S. government can hold - was reached. That means U.S. cash reserves could be exhausted by June 1 according to Treasury Secretary Janet Yellen. Should Republicans and Democrats fail to act, the U.S. could default on its debt, causing harmful effects across the financial system.

The graphic below, via Visual Capitalist's Dorothy Neufeld and Nick Routley, shows the sharp rise in the debt ceiling in recent years, pulling data from various sources including the World Bank, U.S. Department of Treasury, and Congressional Research Service.



Familiar Territory

Raising the debt ceiling is nothing new. Since 1960, it's been raised 78 times.

In the 2023 version of the debate, Republican House Majority Leader Kevin McCarthy is asking for cuts in government spending. However, President Joe Biden argues that the debt ceiling should be increased without any strings attached. Adding to this, the sharp uptick in interest rates have been a clear reminder that rising debt levels can be precarious.

Consider that historically, interest payments on the U.S. debt have been equal to about half the cost of defense. More recently, however, the cost of servicing the debt has risen, and is now almost on par with the defense budget as a whole.

Key Moments In Recent History

Over history, raising the debt ceiling has often been a typical process for Congress.

Unlike today, agreements to raise the debt ceiling were often negotiated faster. Increased political polarization over recent years has contributed to standoffs with damaging consequences.

*For instance, in 2011, an agreement was made just days before the deadline. As a result, S&P downgraded the U.S. credit rating from AAA to AA+ for the first time ever. This delay cost an estimated **\$1.3 billion** in extra costs to the government that year.*

Before then, the government shut down twice between 1995 and 1996 as President Bill Clinton and Republican House Speaker Newt Gingrich went head-to-head. Over a million government workers were furloughed for a week in late November 1995 before the debt limit was raised.

What Happens Now?

Today, Republicans and Democrats have less than two weeks to reach an agreement.

If Congress doesn't make a deal the result would be that the government can't pay its bills by taking on new debt. Payment for federal workers would be suspended, certain pension payments would get stalled, and interest payments on Treasuries would be delayed. The U.S. would default under these conditions.

Three Potential Consequences

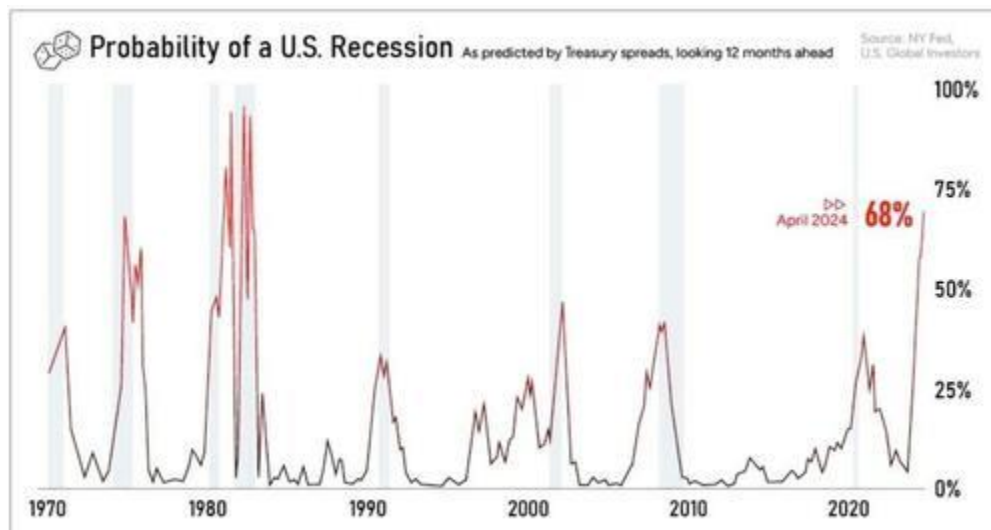
Here are some of the potential knock-on effects if the debt ceiling isn't raised by June 1, 2023:

1. Higher Interest Rates

Typically investors require higher interest payments as the risk of their debt holdings increase.

If the U.S. fails to pay interest payments on its debt and gets a credit downgrade, these interest payments would likely rise higher. This would impact the U.S. government's interest payments and the cost of borrowing for businesses and households.

High interest rates can slow economic growth since it disincentivizes spending and taking on new debt. We can see in the chart below that a gloomier economic picture has already been anticipated, showing its highest probability since 1983.



Historically, recessions have increased U.S. deficit spending as tax receipts fall and there is less income to help fund government activities. Additional fiscal stimulus spending can also exacerbate any budget imbalance.

Finally, higher interest rates could spell more trouble for the banking sector, which is already on edge after the collapse of Silicon Valley Bank and Signature Bank.

A rise in interest rates would push down the value of outstanding bonds, which banks hold as capital reserves. This makes it even more challenging to cover deposits, which could further increase uncertainty in the banking industry.

2. Eroding International Credibility

As the world's reserve currency, any default on U.S. Treasuries would rattle global markets.

If its role as an ultra safe asset is undermined, a chain reaction of negative consequences could spread throughout the global financial system. Often Treasuries are held as collateral. If these debt payments fail to get paid to investors, prices would plummet, demand could crater, and global investors may shift investment elsewhere.

Investors are factoring in the risk of the U.S. not paying its bondholders.

As we can see this in the chart below, U.S. one-year credit default swap (CDS) spreads are much higher than other nations. These CDS instruments, quoted in spreads, offer insurance in the event that the U.S. defaults. The wider the spread, the greater the expected risk that the bondholder won't be paid.

Additionally, a default could add fuel to the perception of global de-dollarization. Since 2001, the USD has slipped from 73% to 58% of global reserves.

Since Russia's invasion of Ukraine led to steep financial sanctions, China and India are increasingly using their currencies for trade settlement. President of Russia Vladimir Putin says that two-thirds of trade is settled in yuan or roubles. Recently, China has also entered non-dollar agreements with Brazil and Kazakhstan.

3. Financial Sector Turmoil

Back at home, a debt default would hurt investor confidence in the U.S. economy. Coupled with already higher interest rates impacting costs, financial markets could see added strain. Lower investor demand could depress stock prices.

Is the Debt Ceiling Concept Flawed?

Today, U.S. government debt stands at 129% of GDP.

The annualized cost of servicing this debt has jumped an estimated 90% compared to 2011, driven by increasing debt and higher interest rates.

Some economists argue that the debt ceiling helps keep the government more fiscally responsible. Others suggest that it's structured poorly, and that if the government approves a level of spending in its budget, that debt ceiling increases should come more automatically.

In fact, it's worth noting that the U.S. is one of the few countries worldwide with a debt ceiling.

Uninvited, I will weigh in on the bet which Ferguson has offered. That China will not be able to overtake the US in nominal dollar terms by 2039. If we take a historical trend analysis approach, yes, China is slowing. But so is the US. Considering the debt situation that won't be solved this time by June 1, or any time in the following decade, it is the US economy that is in deep trouble and unable to find the political leadership that can bring the country out of it. 2039? I think China will overtake the US by 2029. Does it need a repeat of the historical trends to do that? No, instead, we should look at three current circumstances:

- 1) If China's foreign policy on its current trajectory works out, and the BRI starts to unite the entire Eurasian continent, and connecting China to a very friendly Africa,

Central Asia and all the oil rich Gulf States, that grand masterplan of diplomacy will give China a vast hinterland to continue exporting all the products of its vast manufacturing economy. Even the existing G7 countries in Europe will be hard pressed not to participate.

- 2) China will no longer be just about making consuming goods. It is breaking free of the G7 in terms of technology. Just look at Huawei. Once vilified, and battered, it is now recovering very fast and will resume its dynamic growth path. If China makes a breakthrough on graphene technology, that alone will displace all the current leaders in semiconductors and will drive China's technology leadership for the next generation, as the leadership in Chinese space technology is also likely to produce. Then there is the dominance of China in renewable energy, and specifically in EVs in which it has already demonstrated leadership throughout the world, beating all other countries which still make cars with internal combustion engines.
- 3) In education, it is strange to see an intellectual like Ferguson arguing against it, just because there is short term unemployment of new graduates. China's effort to improve the quality of its workforce through advanced education will not hinder it. Education is a core Chinese value, and nothing will stop it. And instead of the people who "tang ping", which is looking at the lowest segment of society and making judgements about the whole country, why not look at the top segment of the same society which has produced ten times the amount of STEM talent than all of Europe and America combined. Maybe Ferguson is right that this will make no difference to economic competition in future decades, but I am not that stupid.

All in all, there is everything going for China and it does not face what the Economist calls its economic "peaking out". In all reality, China is just evolving from a manufacturing economy using a technology base that was invented in the west during the past few decades and it is now on the cusp of reinventing a new industrial base, using 5G, 6G, new energy and new semiconductor technologies which it is showing strong signs of mastering and rolling out.

Hello World!

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Un-Influencer in a World full of Hubris