

The United States and China in the Age of Obama: looking each other straight in the eyes

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Though the United States remains atop the world's power hierarchy, it is becoming less dominant, both because of the rise of new power centers and because the problems are becoming larger. The United States now must function in a world of relatively greater power equality and ever-larger problems springing from interdependence. The United States and China now have to look each other straight in the eyes, with the core of their relationship resting on the strategic foundation of stabilization—stabilization of the global economy, global ecosystem, and global security. This essay makes several additional points: (1) China has made some wise domestic and foreign economic policy decisions in the context of the great economic downturn of 2007–2009 that probably will increase the PRC's relative capacities coming out of the downturn; (2) US–China relations are more fundamentally sound than they have ever been before. Both nations' leaders should seize this opportunity to recast their relationship as partners in the effort to build coalitions to address the global system's most pressing challenges; and (3), even with a relatively sound strategic foundation for bilateral relations, when one moves from the general to the specific in important policy domains, it will be exceedingly difficult for Beijing and Washington to reach agreements on how to proceed on many key issues.

Introduction

The tectonic plates of global geopolitics have been relentlessly shifting for the last two decades, reflecting first the demise of the Warsaw Pact and the Soviet Union; followed by the accelerated rise of China since 1992; the growth of Brazil, Russia, and India; the overstretch of the United States resulting from its responses to the collective events we call 9/11 without simultaneously imposing fiscal and consumption discipline on Americans to pay for those responses; actual and

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potential nuclear proliferation in India, Pakistan, North Korea, and Iran; and, the weaknesses that became glaring in late-2008 in the US-led global financial system that rewarded excessive risk-taking while downplaying regulation. While the US still remains atop the world's power hierarchy, it is becoming less dominant, both because of the rise of new power centers and because the problems are becoming larger.

In this circumstance, a new vision of US–China relations needs to govern the behavior of Washington and Beijing, namely one of partnership in building the coalitions necessary to achieve global economic, ecological (climate change), and security stabilization. Gao Xiqing, president of the China Investment Corporation, during the 2008 US presidential campaign suggested the new US president tell the American people: 'Look, this is war time, this is about the survival of our nation. It's not about supremacy in the world. Let's not even talk about that any more. Let's get down to the very basics of our livelihood'.¹

The national security strategies of Bill Clinton² and George W. Bush,³ different in so many ways, were grounded in the same sense of American primacy and sought to achieve a common objective—to ensure that American power was sufficient to prevail over any single adversary or any imaginable combination of them on a global basis, across the full spectrum of power instruments. The era that nurtured that definition of American capabilities and goals is gone. The National Intelligence Council put it this way in November 2008:

A global multi-polar system is emerging with the rise of China, India, and others . . . The unprecedented shift in relative wealth and economic power roughly from West to East now under way will continue. The United States will remain the single most powerful country but will be less dominant.⁴

This requires adjustment by the United States, its leaders and citizens alike.

Chinese leaders and citizens have a no less important adjustment to make—to gradually meet the expectations of the outside world that China and its people will employ some of their increasing capacities to strengthen the global infrastructure from which the PRC has derived so much benefit over the last three-plus decades. Gone are the days when Beijing could use past injustices and assertions of current infirmities to absolve itself of the need to act. It has befallen presidents Barack Obama and Hu Jintao to guide their nations as they make these adjustments.

There is a certain implied optimism, perhaps hubris, in this article's assertion that the next period of world history will be the 'Age of Obama'. Indeed, that is uncertain for two reasons, one being that, as Hans Morgenthau reminded us, one nation's power depends not only on a nation's actions, but also on the actions of others, in this case China. The People's Republic of China (PRC) has been remarkably successful at enhancing its position along many power dimensions in the last three decades. Moreover, as its performance in the great downturn of 2007–2009 indicates, there exists the possibility, likelihood, that China's decline will be shallower and shorter

1. James Fallows, 'Be nice to the countries that lend you money', *The Atlantic Online*, (December 2008), (accessed 2 February 2009).

2. The United States Department of Defense, *Report of the Quadrennial Defense Review*, (May 1997), p. 5.

3. 'The National Security Strategy of the United States of America', (September 2002), p. 30.

4. National Intelligence Council, 'Global trends 2025: a transformed world', NIC 2008-003, p. iv.

than that experienced by other major powers. If true, this would mean that China could improve its comparative international position in the course of the current economic troubles, though surpassing comprehensive US strength is (considerably) over the horizon,⁵ as the Chinese themselves well understand.⁶ Nonetheless, the basic point is that China aims to move up the value-added chain and become more innovative; to, in short, become a comprehensive military, economic, and intellectual power exercising sway on a global basis. China's objective of becoming the world's leading auto producer is simply one indicator of this aspiration, a goal Western auto industry analysts believe to be realistic: 'When we look back 20 years from now, the year 2009 is likely to be viewed as the year in which the baton of leadership in the global auto industry passed from the United States to China'.⁷ Though this trajectory is not preordained, the West is mistaken if it underestimates China's capacity to do this and similar things.

And second, there is no certainty that the United States will make the decisions necessary to improve the foundations of its own national power, most particularly human and physical infrastructure,⁸ research and development, and sounder fiscal and monetary policy. There is no guarantee that the policies associated with the Obama Administration, and contingent on congressional, private sector, and global system responses, will achieve their intended results. That the US personal saving rate is climbing, reaching well over 5% in April 2009,⁹ is one important move in the right direction, as are the narrowing US global trade deficit in the February 2008 to February 2009 period¹⁰ (though the gap increased somewhat in March and April from its February low) and a seemingly consolidating US banking system. Exploding US Government debt is a more cautionary flag. Further afield, it is impossible to assess how possible developments in North Korea and Iran could complicate or simplify the global circumstance confronting Washington.

The larger message here is that the world has fundamentally changed from its post-World War II incarnations of, first, bi-polarity and then its successor, and perhaps illusory, uni-polar moment. The United States now must function in a world of relatively greater power equality. The United States and China now have to look each other straight in the eyes. Beyond this, this essay makes several points: (1) China has made some wise domestic and foreign economic policy decisions in the context of the great economic downturn of 2007–2009 that will probably increase the PRC's relative capacities coming out of the downturn;¹¹ (2) mutual strategic distrust aside

5. David M. Lampton, *The Three Faces of Chinese Power: Might, Money, and Minds* (Berkeley, CA: University of California Press, 2008), pp. 20–25.

6. Hu Angang and Men Honghua, 'The rise of modern China (1980–2000): comprehensive national power and grand strategy', *Strategy and Management* no. 3, (2002).

7. Kendra Marr, 'As Detroit crumbles, China emerges as auto epicenter', *Washington Post*, (18 May 2009), p. A16.

8. Trends revealed in the International Mathematics and Science Study are adverse to the United States for US fourth and eighth graders; East Asian societies consistently out-perform US students by a considerable margin.

9. For first quarter of 2009, see: Bureau of Economic Analysis, 'Personal saving rate', available at: <http://www.bea.gov/briefm/saving.htm> (accessed 8 May 2009); also related, Neil Irwin, 'Confidence in US economy builds even as recovery still seems distant', *Washington Post*, (2 June 2009), p. A1.

10. US Census Bureau, Bureau of Economic Analysis, 'US international trade in goods and services, February 2009', CB09-BEA09-13, FT-900 (09-02), p. 1.

11. Power is the capacity to define and achieve objectives with the least expenditure of coercive, economic, and intellectual resources.

(and distrust is considerable, particularly within parts of both nations' security establishments), US–China relations are more fundamentally sound than they have ever been before. Both nations' leaders should seize this opportunity to recast their relationship as partners in an effort to build coalitions to address the global system's most pressing problems; and (3) even with a relatively sound strategic foundation for bilateral relations, when one moves from the general to the specific in important policy domains, it will be exceedingly difficult for Beijing and Washington to reach agreement on how to proceed on issues such as global warming, the shape of the new international economic structure, specific security issues (North Korea, Pakistan, Afghanistan, and Iran, as well as enlarging Chinese military power projection capacities themselves), not to mention perennial abrasions such as Taiwan, Tibet, and other regional issues.

The prospects, therefore, are for a fundamentally stable relationship that taxes the elites and publics in both countries with the relationship's bargaining treadmill quality and half-a-loaf outcomes. Not long ago there was a consensus among the cognoscenti that China was a 'reactive' and essentially 'defensive' regional power. This is changing, and doing so rapidly, a reality evident in everything from the calls by some Chinese for a diminished international role for the US dollar, to: anti-satellite tests; Beijing's willingness to muscularly assert its interests in its maritime exclusive economic zone; a somewhat more assertive role in United Nations deliberations;¹² increased publicity for new PRC weapons systems and defense capacities including in space, under sea, and in cyberspace; demands for a bigger role in the decision-making of multilateral financial institutions; and, a more active role in providing development assistance to an increasingly broad array of countries. The two nations have reached the point where neither side can afford a rupture with the other. Both sides need to cooperate. It will not be easy in many areas.

China's response to the great downturn of 2007–2009 and its implications

There has been, and remains, ample basis for uncertainty, perhaps skepticism, concerning the PRC's prospects in the current global economic downturn. The value of China's total trade equals 68.7% of its GDP¹³ and its exports in April 2009 were down 22.6% from the same month a year earlier—the value of its exports of goods and services equals 38.8% of GDP.¹⁴ These developments have been associated with the closure of tens of thousands of enterprises in China's coastal areas, with the National Statistics Bureau asserting in March 2009 that 23 million migrant workers had lost their jobs.¹⁵ We cannot be certain how all this may affect social stability in

12. Richard Gowan and Franziska Brantner, *A Global Force for Human Rights? An Audit of European Power at the UN* (London: European Council on Foreign Relations, 2008), available at: www.ecfr.eu.

13. National Bureau of Statistics, Table 2-1 ('Gross domestic product') and Table 17-1 ('Foreign trade and economic cooperation'), available at: www.stats.gov.cn; see also, Economist Intelligence Unit, 'Country profile 2009—China', p. 23, available at: www.eiu.com.

14. *Xinhua*, 'China's foreign trade down for sixth month', (13 May 2009), available at: <http://tradeinservices.mofcom.gov.cn/en/local/2009-05-13/72066.shtml> (accessed 22 May 2009); for an earlier report, see Bettina Wassener, 'Chinese exports fall for fifth month, but more slowly', *New York Times*, (11 April 2009), p. B5.

15. Louisa Lim, 'Unemployment swells in China', *National Public Radio*, (6 April 2009), available at: <http://www.npr.org/templates/story/story.php?storyID=10314269>.

China but we can see the scale of the challenge; China will have to find an estimated total of 39–48 million jobs for non-agricultural job seekers in 2009.¹⁶ Moreover, China is pushing loans out the bank doors to such an extent one has to wonder about the future's burden of non-performing loans (NPLs)—bank loans in the first five months of 2009 exceeded the total bank lending target for the preceding year.¹⁷

Nonetheless, it is wise to examine the many reasons that China probably will come through this downturn in better shape than many analysts think. During the Asian Financial Crisis of 1997–1998 China invested in infrastructure and actually came out of that downturn in a better competitive position than it went into it. At that time, many of the fundamentals of China were weaker than they were at the outset of the current global crisis in late 2008. This is not to assert that untoward developments cannot occur; it is to say that there are quite plausible better scenarios. By 'better scenario', I mean that China's *annual* growth rate bottoms out at 7% or higher (though quarterly rates may fall, and indeed have fallen, below that number) and that China emerges in a stronger competitive posture than it went into the downturn. Professor Pieter Bottelier has distinguished China's 'growth recession' (a situation in which growth drops, but remains positive) from the genuine 'recession' experienced by the world's other major economies—sustained, negative GDP growth.¹⁸

Among the factors that make this likely are the following: China got an early start in dealing with economic instabilities when it began to cool its economy (particularly in the housing sector, food prices, and the equities markets in late 2007); then, when exports began to decline rapidly, Beijing halted revaluation of the RMB, promptly implemented several interest rate cuts, gave value-added tax rebates to key export sectors, and reduced some of the costs associated with hiring workers.¹⁹ In addition, other considerations lead in a generally hopeful direction:

- China is gingerly moving ahead on land transfer policy (to promote productivity growth in agriculture) for the rural population; certainty about the economic terms of land transfers in rural areas (land contracts would 'not change for a long time'²⁰) should boost rural investment, augment the consumption resources of hundreds of millions of rural dwellers over time, encourage the more efficient use of land resources, and accelerate the process by which the status of urban and rural citizens is equalized. Nonetheless, this will take time and remains politically controversial both in conception and detail among Chinese policy makers as seen from the compromise document issued at the Third Plenum of the 17th Party Congress of fall 2008.²¹

16. Pieter Bottelier, 'China's economic downturn: employment is the critical issue', *The Jamestown Foundation—China Brief* 1(3), (4 February 2009), p. 3.

17. Justine Lau and Jamil Anderlini, 'China stimulus starts to pay off', *Financial Times*, (13–14 June 2009), p. 2.

18. Pieter Bottelier, Donald Hanna and Albert Keidel, 'Is China's economy tanking?: understanding China's new GDP figures', Carnegie Endowment for International Peace, Friday, 30 January 2009, transcript by Federal News Service, Washington, DC.

19. In much of the economic analysis below I am indebted to the work of Professor Pieter Bottelier, including the following: Bottelier, 'China's economic downturn'; see also, Bottelier *et al.*, 'Is China's economy tanking?'.

20. Joseph Fewsmith, 'Tackling the land issue—carefully', *China Leadership Monitor* no. 27, (Winter 2009), p. 7, available at: www.chinaleadershipmonitor.org (accessed 27 April 2009).

21. *Ibid.*

- The bulk of China's growth has been driven by internal factors, not the least urbanization and the growth of the middle class, which means there remains great potential to fuel future expansion. The urbanization of 300 million persons has helped drive rapid growth for 30 years, and there are an additional approximately 400 million persons 'waiting' to be urbanized. As one indicator, automobile sales in China were 25% higher in April 2009 than they were in April 2008.²² Particularly important to future economic growth in China is demand for affordable housing, which is an important part of Beijing's stimulus efforts.
- The central government in Beijing has more leverage over local governments than it did prior to 1994. As Barry Naughton explains:

Since the 1994 tax reform, however, the central government spends directly about 30 percent of all expenditures. Local governments are now dependent on central government transfers that pass on about 20 percent of total revenues to them. This arrangement enhances the central government's overall position and gives it a stronger bargaining position vis-à-vis local governments.²³

- China's debt situation was quite manageable prior to the onset of the current global downturn, meaning that the PRC now does not have the agonizing deleveraging problems facing the US financial system and the American consumer. Overall, Chinese household debt is about 14% of GDP (as contrasted to 100% in the United States) and the government debt-to-GDP ratio is 15.5%—Japan's is close to 170%.²⁴ Finally, China has a relatively low foreign debt-to-GDP ratio, being about 8.5% in 2008, with the percentage of government debt in long- and medium-term instruments rising and the amount of short-term external debt falling 4.23%.²⁵ In short, China is in nearly the opposite position to the US Administration which faces the problem of deleveraging American consumers and financial institutions and having relatively high levels of government debt itself. With US financial institutions and consumers deleveraging, it is hard to keep aggregate demand up. In boosting short-term aggregate demand, the US Government is assuming much more debt, hopefully for only a short period, raising the question of how the US fiscal system will be put on a more sustainable fiscal basis once growth is restored to the American economy.
- Beijing's national budget (the combination of central and local government expenditures) was very near to balance, with only a slight deficit in budget year 2008.²⁶ This, combined with a low government debt-to-GDP ratio, has given the central government room to deal with the 2008–2009 growth recession. The sound fiscal fundamentals, in turn, account for the magnitude of China's

22. Marr, 'As Detroit crumbles, China emerges as auto epicenter', p. A16.

23. Barry Naughton, *The Chinese Economy* (Cambridge: MIT Press, 2007), p. 435.

24. Japan's Ministry of Finance, available at: <http://www.mof.go.jp/english/bonds/saimukanri/2008/saimu03-1a.pdf>; see also, CIA, *World Factbook 2008*; see also, <http://livenews.com.au/rss-link/china-1-rebound-to-help-australia/2009/5/8/205643> (accessed 20 May 2009); also, David M. Lampton, 'Notes of meeting with senior executive, Bank of China', 19 March 2009, p. 17.

25. 'China's external debt rises slightly in 2008', *Xinhua*, (24 April 2009). For 2007 figures, see, 'China's economic statistics', available at: <http://www.uschina.org/statistics/economy.html> (accessed 21 April 2009).

26. 'Comparison: report on implementation of PRC 2008 budgets, draft budgets for 2009', *Xinhua Domestic Service*, (21 March 2009), made available from World News Connection.

announced 9 November 2008 fiscal stimulus (for 2009–2010) of RMB 4 trillion,²⁷ or about 6% of GDP per year for two years,²⁸ almost double the annual magnitude of stimulus represented by the Obama Administration's efforts to date in the United States.²⁹

- Although we need to know much more about the kinds, and quality, of infrastructure projects that are receiving funds as part of the Chinese government's stimulus efforts, Dr Nicholas R. Lardy argues that China is using infrastructure investments to boost long-term productivity—on railroads, more efficient power grids, urban water and sanitation projects, and metropolitan transport undertakings,³⁰ not to mention low-cost housing, education, and health system improvements that hopefully will not only stimulate growth and employment, but also head in the direction of a badly needed rebalancing of the Chinese economy toward domestic consumption. As one senior Chinese banking leader put it to me in March 2009, 'This is a wonderful opportunity for us, like nuclear plants, great trains. Build toll roads ...'.³¹ While we know that actual implementation can diverge from policy rhetoric along many dimensions that degrade effectiveness, at the policy level the Chinese seem to be headed in the right direction.
- Chinese banks are in good shape. They are much better capitalized than they were in the Asian Financial Crisis, with NPLs now at a far lower relative level than in 1997–1998—I was told in March at the Bank of China that the NPL rate was 3%.³² Indeed, Chinese banks have become very profitable in recent years. Of the world's top four financial institutions ranked by net cash position, three are Chinese banks.³³ Further, China's exposure to foreign 'toxic assets' (what some Chinese call 'hi-tech investments') is relatively low, with the Bank of China reportedly having an exposure in the US\$4–5 billion range as of the first quarter of 2009;³⁴ the Bank of China was hit by the collapse of Lehman bonds 'only' to the tune of US\$758 million.³⁵ As mentioned above, in the first five months of 2009 China's banks dramatically increased lending. This bloated lending may create loan non-performance problems in the future, but is an enormous stimulus in the

27. 'Wen Jiabao presides over State Council meeting on stimulus package to boost economy', *Xinhua*, NewsEdge, Document Number: 200811091477.1_298b002cdc4f74d4.

28. Since the stimulus number was intended to cover two years, the yearly rate of spending is presumably about one-half the total, though it may be front loaded. Albert Keidel, 'China's stimulus lesson for America', Web Commentary, Carnegie Endowment for International Peace, November 2008, p. 1.

29. There is considerable uncertainty over how much of China's stimulus is actually new money, with some funds being provided by central and local governments and some through the banking system. It also is true that government officials and bankers in China are concerned that not all the money will be used efficiently.

30. Remarks by Nicholas R. Lardy at Principia College Conference, *China Rising*, (3 April 2009). Indeed, much of the analysis in this section draws on the analysis of Dr Lardy at this conference. See also: http://www.nytimes.com/2009/01/23/business/worldbusiness/23yuan.html?_r=1&scp=1&sq=china's%20route%20forward&st=cse (accessed 13 May 2009).

31. Lampton, 'Notes of meeting with senior executive, Bank of China', p. 20.

32. *Ibid.*, p. 16.

33. Richard Milne, 'Berkshire and China banks top cash-rich groups list', *Financial Times*, (30 December 2008), p. 13.

34. 'Bank of China announces 2009 first quarter results profit attributable to shareholders reached RMB 18.57 billion', available at: http://www.boc.cn/en/bocinfo/bi1/200904/t20090428_673793.html.

35. Lampton, 'Notes of meeting with senior executive, Bank of China', p. 16.

short run. In terms of the benchmark lending rate, it has been reduced five times since September 2008.³⁶

- Exports are important in a variety of ways to China (revenue generation at all levels, technology and skills transfers, and employment), but when one considers the low (though climbing) value-added in China to the PRC's processing export volume for all merchandise (calculated to be 18.1% according to the National Bureau of Economic Research³⁷), the impact of falling exports is less catastrophic for the economy than one might conclude by simply looking at the headline numbers on declining exports and the nominal percentage of GDP represented by them. Further, when Chinese exports fall, many of the imported inputs needed for those now non-existent exports also automatically fall, thereby lessening the impact on the trade balance. Moreover, it has not been fully appreciated the degree to which China has robustly diversified away from an over-reliance on exports to Japan, Europe, and the United States, which now account for about half of Chinese exports—the remaining half goes to the rest of the world, notably Africa, Latin America, the Middle East, Southeast Asia, Australia, New Zealand, and Canada. Indeed, in June 2009, the BRIC Countries (Brazil, Russia, India, and China) met in Moscow to further enhance trade and economic policy cooperation.³⁸ Having said all this, falling exports are a real problem,³⁹ as acknowledged by a senior Chinese banking official to me:

The real thing that is hurting us is the Western recession ... 38% [of GDP] is exports and of this, 18% of [our] exports are to the US, and 20% to Europe. In 2007 [our growth rate] was 11%, and 2.7% of this from net exports. Net export growth [decline] has got us to 9% growth.⁴⁰

- With respect to the balance of trade, China's position is strong. Chinese imports during the January–April 2009 period dropped 28.7%,⁴¹ so that the PRC still was running a global trade surplus of considerable magnitude; the PRC ran a global trade surplus in 2008 of US\$295.5 billion.⁴² However, while this phenomenon provides China with plenty of foreign exchange, it perpetuates a dangerous imbalance in the global economic system.
- While declining commodity prices around the world hurt commodity exporters, China is a net importer of huge quantities of commodities. Low commodity prices help keep the prices of its manufactured exports (and domestic inflationary pressures) lower and provides a window of opportunity for the PRC to buy

36. 'China has room to further cut interest rates', *Xinhua*, (9 March 2009).

37. Robert Koopman, Zhi Wang and Shang-jin Wei, 'How much of Chinese exports is really made in China?: assessing domestic value-added when processing trade is pervasive', National Bureau of Economic Research, (June 2008), Working Paper 14, p. 109, available at: <http://www.nber.org/papers/w14109>. The total domestic value-added for all merchandise exports in China is 50.7%.

38. Ming Jinwei, 'Meeting of BRIC leaders set to promote cooperation among each other', *Xinhua*, (14 June 2009), available at: http://news.xinhuanet.com/english/2009-06/14/content_11540142.htm (accessed 16 June 2009).

39. The World Trade Organization estimates that exports will decline 9% worldwide in 2009. See *Washington Post*, (23 April 2009), p. A18.

40. Lampton, 'Notes of meeting with senior executive, Bank of China', p. 17.

41. General Customs Administration of the People's Republic of China, 'Gross imports and exports kept month-to-month climbing in April', available at: <http://data.acmr.com.cn> (accessed 12 May 2009).

42. See <http://www.uschina.org/statistics/tradetable.html> (accessed 21 April 2009).

long-term access to commodities through acquisitions abroad, acquisitions it can afford with its nearly US\$2 trillion foreign exchange holdings. There have been a number of notable acquisitions, purchases of interests in foreign firms, and loans in exchange for long-term commodities supply deals, including those with: Russia's Rosneft and Transneft groups, Brazil's Petrobras,⁴³ Chinalco's proposed (unsuccessful) play for Rio Tinto, Ansteel's acquisition of a 36% position in Australia's Gindalbie Metals, and Petrochina's purchase of a share in MMG in Kazakhstan.⁴⁴ In June 2009 at a summit of the Shanghai Cooperation Organization (SCO) of four Central Asian states, Russia, and China, Hu Jintao offered the Central Asian participants loans that could total US\$10 billion. With respect to acquisitions, recent moves have not been limited to commodities but also include high technology and research firms abroad. As my notes with one senior interviewee put it,

China will be in manufacturing for a while. So, we need technology, energy efficiency, resources. Every day China is buying SMEs (small and medium enterprises) [abroad]. This is serious business. Buy German companies and ship them to China.

- The RMB is becoming a more significant currency globally. Beijing has implemented currency swap arrangements (US\$95 billion as of April 2009⁴⁵), loans, and RMB credits involving Russia, Kazakhstan, Brazil, Venezuela, Hong Kong, the Republic of Korea, Argentina, Indonesia, Malaysia, and Belarus. Further, while figures are lacking, tied Chinese foreign aid is growing; for example, Beijing provided Mongolia with US\$300 million in loans amidst Ulaanbaatar's collapsing government finances that mirrored the collapse of world commodities prices.⁴⁶ These and other arrangements will gradually set the stage for the RMB to be used increasingly frequently as a currency for trade settlement and it should help buoy Chinese exports to the rest of the world. Of course, the increasing use of the RMB in trade raises longer-term issues about the US dollar and its role. As one senior Chinese banking official put it in an interview, 'The world needs a diversified currency structure. The euro is not good to balance the dollar or the yen'.⁴⁷ Unspoken was Beijing's ambition to make the RMB a global currency, albeit over what time horizon is unclear.
- And finally, while the foreign media focus on shuttering export-oriented factories along China's coast, we do not yet know what percentage of these enterprises may have moved production further inland, merged with other more efficient export entities, or otherwise adapted in ways that boost China's future competitiveness.

All this is not to say that China has no problems. Especially worrisome to the Chinese is the possibility of a protracted recession in their major export markets and the difficulty they are having moving to a more balanced growth model in which

43. Geoff Dyer, 'Anxious China turns charm on Europe', *FT.com*, (23 February 2009), available at: http://www.ft.com/cms/s/0/cfa1382c-0392-11de-b405-000077b07658.html?nclick_check=1 (accessed 13 May 2009).

44. 'Petrochina', *Financial Times*, (29 April 2009), p. 12.

45. 'Taking the summit by strategy', *The Economist*, available at: http://www.economist.com/world/asia/PrinterFriendly.cfm?story_id=13447015 (accessed 6 May 2009).

46. 'Cash-strapped Mongolia buys time with loans', *Mining Weekly*, (22 April 2009), available at: <http://www.miningweekly.com/article/cash-strapped-mongolia-buys-time-with-loans-2009-04-22> (accessed 20 May 2009).

47. Lampton, 'Notes of meeting with senior executive, Bank of China', p. 21.

domestic consumption plays a major role and investment and exports a less critical part. Also, if global growth stays low for a protracted period, for how long will Beijing be able to prime the spending pump without igniting serious inflation? The Chinese economic leadership is also worried about the housing sector and the great excess inventory of unoccupied space, though in the first quarter of 2009 there were signs of a turnaround. And, Beijing is worried about what slower economic growth will mean for (particularly local) government revenues over the short and medium runs. There also may be a large overhang of troublesome NPLs in the future. At a minimum, however, China's relatively strong position in this global circumstance means that other nations have more reasons to cooperate with the PRC than not and it is likely to lose less than others in this crisis and improve its relative power position. Beijing's efforts to keep its own economy growing generally have served interests far beyond the PRC's own borders, not the least commodity exporters that recently have seen prices rising. And this brings us to the foundations of this new era's US–China relationship.

The strategic and domestic foundations for US–China relations

A convergence of strategic circumstance, domestic leadership, and public opinion in both countries has created an environment conducive to fundamentally stable, though not frictionless, US–China relations. The basic building blocks of this foundation will remain in place for some time. Saying this is not to assert that one could not imagine adverse developments—a collapse of globalization and a balkanization of the world economy, a Taiwan imbroglio, or a North Korea meltdown, for instance, would or could put US–China relations, and the rest of the world, on a far different path.

*Significant strategic convergence*⁴⁸

Though Fred Bergsten's promotion of the 'G-2' idea ('develop a G-2 between the United States and China to steer the global governance process'⁴⁹) is not an idea that should be pursued, the proposal does reflect a growing recognition that many world problems (with respect to *global economic stabilization*, *global ecological stabilization*, and *security stabilization*) cannot be effectively addressed unless the United States and China have reasonably consonant positions.⁵⁰ Nonetheless, the G-2 formulation should not be the formulation because the world faces many problems, and in different problem areas different countries will be more or less important. For each problem a different coalition will need to be built. To operate within a framework that seemingly excludes so many others whose cooperation will be needed is unwise. The Chinese seem to think so as well, with Premier Wen Jiabao

48. I say 'significant' strategic convergence because there remains worrisome strategic mistrust, particularly in the two nations' security establishments, as well as in the respective publics, as discussed below.

49. C. Fred Bergsten, 'A partnership of equals: how Washington should respond to China's economic challenge', *Foreign Affairs* 87(4), (July/August 2008), pp. 57–69, especially pp. 66–69.

50. Zbigniew Brzezinski formulated the proposition a bit more cautiously when he called for an 'informal G-2'. See his, 'Address under the theme of "The strategic significance of normalization of Sino–American relations"', *Foreign Affairs Journal*, Special issue, (January 2009), p. 18.

saying as much in Prague in May 2009. As the *Xinhua* News Agency put it in June 2009: ‘Another exclusive club will do no good in this regard and it is very encouraging to see the meeting of the BRIC countries’ leaders emerge as an open forum’.⁵¹ The vision the United States and China should have is to be cooperative coalition builders; they should strive to be the critical mass to help address a broad range of global issues.

The idea of *stabilization* is the central common interest that supports US–China relations. This diversified base for US–China relations is intrinsically a firmer, interest-based foundation for ties than was the initial pillar of relations in the 1960s–1980s—explicit and quite broad-ranging anti-Soviet cooperation. With the demise of the Soviet empire and the Soviet Union itself in the 1989–1991 period, punctuated by the Tiananmen tragedy of June 1989, the US–China relationship came to rely upon an economic rationale vulnerable to human rights and security critics. It is notable that on her February 2009 trip to Asia, in Seoul Secretary of State Clinton noted that,

Successive administrations and Chinese governments have been poised back and forth on these issues [human rights related concerns], and we have to continue to press them. But our pressing on those issues can’t interfere with the global economic crisis, the global climate change crisis, and the security crisis.⁵²

Beyond these overlapping, strategic concerns is a more fundamental reality—both nations are so preoccupied with their domestic problems, and so motivated to minimize the drain of foreign entanglements, that neither leadership believes that it can afford a major problem with the other. A January 2009 Pew public opinion poll reported that 71% of Americans wanted their incoming president, Barack Obama, to focus on domestic affairs—only 11% said the focus should be on foreign affairs.⁵³ As for the Chinese, Beijing never tires of repeating the mantra that foreign policy serves to provide an environment for the peaceful pursuit of domestic modernization.

In both Beijing and Washington, therefore, there has been strategic convergence in the sense that both countries have domestic reform agendas of similarly sweeping scope (building, or rebuilding, the middle class; strengthening the social safety net; reforming education; reforming financial institutions; and reforming health care delivery) which creates a jointly shared predisposition to avoid problems with each other. At the international level, interdependence has transformed previously ‘soft’ transnational issues into ‘hard’ security issues—such as climate change. ‘Hard’ issues are more compelling politically than ‘soft’ ones and these challenges cannot be addressed without a considerable degree of bilateral cooperation. Unheralded, the US–China relationship has slid into a new strategic rationale.

All this is not to deny that within the two nations’ security establishments a negative, co-dependence has developed in which the hedges and military modernization that each side wishes to undertake is justified by reference to the

51. Ming Jinwei, ‘Meeting of BRIC leaders set to promote cooperation among each other’, CPIFA, (June 2009), p. 18.

52. ‘Clinton: Chinese human rights can’t interfere with other crises’, *CNN*, (22 February 2009), available at: <http://www.cnn.com/2009/POLITICS/02/21/clinton.china.asia/> (accessed 6 May 2009).

53. The Pew Research Center for the People & the Press, ‘Economy, jobs trump all other policy priorities in 2009’, (22 January 2009), available at: <http://people-press.org/report/485/economy-top-policy-priority> (accessed 18 February 2009).

actions and future potentials of the other. The security hawks in each system are each other's biggest allies. One observes this in growing naval, air, space, and cyber capabilities each side is acquiring.

Leaders and the public opinion setting in which they operate

Looking simply at the Chinese leadership, and the emerging Obama Administration's ranking appointments, one can see the importance Beijing and Washington attach to relations with each other. One of the first post-inauguration foreign leader phone conversations President Obama conducted was with President Hu Jintao—whom the US president called⁵⁴—whereupon the new US president is reported by Beijing (*not* the White House⁵⁵) to have described the bilateral relationship as: 'the most important bilateral relations for both sides'.⁵⁶ If the Chinese account of the conversation is true (which I imagine US allies assume it is), it must be jarring for Washington's traditional allies to hear this formulation. The importance of Asia for the new administration also was reflected in the fact that Secretary Clinton made her first trip abroad to Asia (though going to regional allies, Japan and the Republic of Korea, before China). For its part, China received Secretary Clinton at the highest level and sent Foreign Minister Yang Jiechi to Washington to work out the details for the first face-to-face meeting of the two presidents, this one in London in the context of the April 2009 G-20 meeting. At the London meeting of the two presidents, President Obama agreed to visit China in 2009 and they settled upon a somewhat modified format by which high-level dialogue between the two nations would continue—the US–China Strategic and Economic Dialogue, with the treasury secretary taking the lead on economic issues and the secretary of state doing so with respect to diplomatic and other related issues.⁵⁷ Immediately thereafter, in May–June, Treasury Secretary Geithner was in Beijing calling for what I would characterize as reciprocal actions in which the United States would increase savings and fiscal discipline and China would boost domestic consumption and exchange rate flexibility.

Turning to personnel, if one examines the ranking and early appointments of the Obama Administration one is struck by the degree of China-relevant experience and by the degree to which the policy interests and responsibilities of several ranking appointees require productive relations with Beijing.⁵⁸

- *Secretary of State Hillary Clinton* was of some initial concern to Beijing because of her prior interactions with the PRC, most particularly the Fourth World

54. 'Press briefing by Press Secretary Robert Gibbs, January 30, 2009, 5:00 PM', available at: http://www.whitehouse.gov/the_press_office/Press_Briefing_1-30-09/.

55. The White House Office of the Press Secretary, 'Readout on the President's call to Hu Jintao', (30 January 2009).

56. 'China's Hu holds phone talks with Obama over ties', *Xinhua*, available at: http://new.xinhuanet.com/english/2009-01/31/content_10738708.htm.

57. I say 'modified' form because in the administration of George W. Bush the treasury secretary acted solo in a super-cabinet role and there was a separate Senior Dialogue between the two diplomatic establishments conducted at the deputy secretary level.

58. The list that follows is only a partial list of those appointed as of August 2009 and there are other important positions that will be filled over time. Also to be determined over time will be the relative heft of various individuals and departments that will emerge from the inevitable bureaucratic friction that is a natural part of governance. This, therefore, is a preliminary assessment.

Conference on Women held in Beijing in 1995 at which time she delivered a speech unwelcome by her hosts. These Chinese concerns, however, were substantially assuaged with her trip to Beijing in February 2009. The Secretary signaled continuation of high-level economic and strategic dialogue and underscored the centrality of economic, ecological, and security stabilization over other (though also important) issues such as human rights.

- *Treasury Secretary Timothy Geithner* has a long-term personal and family involvement in Asia, not least China, has considerable knowledge of the language and situation on the ground there, and much of the media discussion of his Senate confirmation hearing testimony pertaining to China's 'currency manipulation' proved off the mark when in April 2009 the Treasury Department in its semi-annual currency report to Congress declined to designate the PRC a currency manipulator, a legal designation with implications. Indeed, in his testimony before Congress Geithner declared his desire to 'do more good than harm' as he addressed the contentious issue of China's exchange rate.⁵⁹ The point is not that Secretary Geithner or any of the other officials discussed here confuse American and Chinese interests, it is merely to observe that they have experience in this region, recognize the complexities, and attach importance to China within the broader regional and global contexts.
- *Energy Secretary Steven Chu*, a Nobel Prize winning Chinese-American physicist, is committed to tackling the global carbon problem, a challenge that simply cannot be effectively addressed without cooperating with China (and India).
- *Defense Secretary Robert Gates*, the lone cabinet holdover from the Administration of George W. Bush, is closely associated with George H. W. Bush, including the period when Gates was president of Texas A&M University, where Bush senior's presidential library is located. His views on China are broadly consonant with those of both presidents Bush and it is unsurprising that, in the wake of taking over from former Secretary Donald Rumsfeld at the Department of Defense in December 2006, Gates moved more vigorously than his predecessor in the direction of enhancing US–China military-to-military and security interactions, including in the nuclear area.
- *Commerce Secretary Gary Locke*, a Chinese-American former governor of the State of Washington, was the chief executive in a state with a high level of trade and other interactions with China. Washington State firms have large interests in China (e.g. Microsoft and Boeing). The state had US\$9.6 billion in exports to the PRC in 2007, with its exports to China (its number one export market) growing 406% in the 2000–2007 period, while its exports to the rest of the world grew only 87% during the same time frame. Transportation equipment and agricultural products were the state's biggest export categories.⁶⁰ Locke is well known to Chinese leaders.
- *Ambassador Jon Huntsman* of Utah had wanted to be ambassador to China for George W. Bush. He is a rising star within the Republican Party and in his youth

59. Finance Committee Questions for the Record. United States Senate, Committee on Finance, Hearing on Confirmation of Mr Timothy F. Geithner to be Secretary of the US Department of Treasury, 21 January 2009, available at: <http://www.finance.senate.gov/sitepages/leg/LEG%202009/012209%20Questions.pdf>, p. 81.

60. The United States–China Business Council, 'Washington exports to China', available at: <http://www.uschina.org> (accessed 18 May 2009).

was a missionary in Taiwan for the Church of Jesus Christ of Latter-day Saints—he speaks Chinese. He has an adopted Chinese daughter, has a family background in the chemical business, and given his responsibilities in Utah knows the importance of the economic relationship with the Mainland—Utah exports to China in the 2000–2007 period grew 1,086% while the state’s exports to the rest of the world grew only 133% during the same period. The PRC is Utah’s fifth largest export market, following Japan.⁶¹

- One could go further in identifying appointees with considerable knowledge and sophistication concerning East Asia, and China in particular: White House appointees (Larry Summers of the National Economic Council; and Mr Jeffrey Bader, senior director for Asian affairs at the NSC); political appointees and career officials at the Department of Defense, including Ashton Carter, under secretary for defense acquisition; the Director of National Intelligence (DNI) Admiral Dennis Blair, former commander-in-chief of the Pacific; and other political appointees at the Department of State (including James Steinberg and Kurt Campbell), not to mention the capable career officials there. To underscore, this is not to prejudge how any of these individuals might come out on specific, complex policy issues nor is it to suggest an inability to distinguish between Chinese and American interests. Rather, it is to say that the quotient of experience is high and the predisposition toward a cooperative framework is present.

Because I have written about Chinese leadership and leadership development elsewhere, as have many others such as Cheng Li,⁶² I will not treat PRC counterparts and other leaders with parity. I note, however, that in the diplomatic realm PRC counterparts to the Americans mentioned above (State Councilor Dai Bingguo, Vice Premier Wang Qishan, Foreign Minister Yang Jiechi, and head of the Taiwan Affairs Office Wang Yi), and China’s leaders more broadly throughout the system, represent a positive combination of competence and commitment to the relationship.

Public opinion is important as well. Here we have a circumstance in which the respective publics in both countries have their anxieties about the other society, but the degree of mutual mistrust does not assume unmanageable proportions or force leaders into generally unproductive postures—*public opinion is permissive*. For instance, a January 2008 Gallup Poll found that 14% of Americans were willing to designate China as the ‘United States’ greatest enemy’.⁶³ This poll was conducted toward the end of the Bush Administration, with the presidential campaign heating up. One suspects that the onset of the global economic downturn and the resultant focus on domestic concerns have given resonance to DNI Blair’s 25 February 2009 congressional testimony that: ‘The primary near-term security concern of the United States is the global economic crisis and its geopolitical implications’.⁶⁴ If one looks at comparative American ‘favorability ratings’ of 19 countries as measured by the

61. The US–China Business Council, ‘Utah exports to China’, available at: www.uschina.org (accessed 19 May 2009).

62. Cheng Li, ‘China’s team of rivals’, *Foreign Policy* no. 171, (March/April 2009), pp. 88–93.

63. See <http://www.gallup.com/poll/105835/North-Korea-Drops-Top-Three-US-Enemies.aspx?version=print> (accessed 13 February 2009).

64. Dennis Blair, ‘Annual threat assessment of the intelligence community for the House Permanent Select Committee on Intelligence’, available at: http://www.dni.gov/testimonies/20090225_testimony.pdf.

Gallup organization in February 2009, it is striking that China is in the middle of the pack at number 10, preceded by Israel (number 7), Egypt (number 8), and Mexico (number 9), and followed by Russia (number 11), Saudi Arabia (number 12), and Cuba (number 13).⁶⁵

In China, while there is a lively debate about whether globalization is good or not, and the United States is popularly blamed for being the incubation site of, and the vector for spreading, the global economic contagion, the Beijing leadership is not under unmanageable popular pressure in its dealings with Washington. Of course, unanticipated events that trigger nationalism and create opportunities for popular mobilization in both nations can rapidly change this circumstance. It also is true that US attitudes toward China have never fully recovered from the mid-1989 reversal of sentiment that immediately followed the Tiananmen events.

In sum, if we assert that *stabilization* (of the global economy, ecology, and security environment) is the core common interest between the United States and China in the current era, both sides have in place personnel that not only are in tune with that broad vision, but who have considerable experience dealing with one another and this range of problems. The public opinion setting in both countries has its populist and negative dimensions, but is not driving leaders toward policy excess. All these considerations, however, will not resolve, or preclude, many problems, the topic to which we now turn.

Wishing does not make it so

Four issue sets indicate the complexities and frictions that await the Obama Administration and its Chinese counterparts as they seek to move along a more cooperative path. The negotiations and compromises that lie ahead, under the best of circumstances, will tax the patience and wisdom of leaders in both societies. Leaders in Beijing and Washington will have to spend considerable effort educating and restraining their own publics and locally-oriented politicians so they have the freedom to make essential accommodations.

Climate change

My March 2009 discussions with non-governmental organizations in China and with the Chinese Foreign Ministry underscored that reaching agreement with the PRC on how to address the global climate change challenge will be difficult, with the December 2009 conference in Copenhagen being an important milestone and driver for bureaucratic action.⁶⁶ China's leaders believe that there is a global climate change problem; reducing carbon dioxide (CO₂) emissions is essential; the consequences of global warming will be especially hurtful to China; and, that the PRC has responsibilities to address the problem.⁶⁷ So far, so good. It is when one gets to the

65. Lydia Saad, 'Canada remains Americans' most favored nation', *Gallup Poll*, (9–12 February 2009), available at: <http://www.gallup.com/poll/115258/Canada-Remains-Americans-Favored-Nation.aspx?ve> (accessed 29 March 2009). Canada has the highest favorability rating and Iran the lowest.

66. Indeed, the Copenhagen Conference probably will only be a way-station along a long path.

67. In terms of Chinese Government documents see, *White Paper: China's Policies and Actions on Climate Change*, available at: http://www.china.org.cn/government/news/2008-10/29/content_16681689.htm (accessed 5 May 2009).

next levels of detail that one encounters problems in terms of internal discussions and debates within China and the United States themselves, and in terms of bilateral discussions.

The United States and China may make progress on this issue in 2009, but meaningful progress will come only to the extent that both sides compromise on their initial positions, with the Chinese willing to make verifiable commitments and the Americans willing to accept Chinese progress in emitting less CO₂ than otherwise would be the case due to improving energy efficiency, at least for a transitional period. Further, if there is an eventual positive outcome when the two presidents meet in late-2009 in Beijing in the run up to Copenhagen, that positive outcome likely will involve joint energy and climate-relevant research and technology exchange/transfer, and co-development. There also may have to be a bigger role than many currently envision for adaptation rather than an exclusive focus on CO₂ reduction. In addition to the difficulties in reaching this kind of compromise between the executive authorities in both countries, the US Congress must be willing to accept it as well, and there are serious divisions on these issues within each house of Congress, between the two houses of Congress, and between the executive and legislative branches.⁶⁸

If one examines the core ideas underlying current discussion in the US Administration's opening months, two concepts appear to be key—mandatory targets and absolute reductions in the volume of CO₂ emissions; the preferred mechanism seems to be cap-and-trade (with perhaps some thought given to taxes on carbon). If one listens carefully to what the Chinese say, as I did in Hubei Province and Beijing in March 2009, one hears the words 'voluntary' and targets for the reduction of 'energy intensity per unit of GDP' and one hears an emphasis on the need for the developed world to transfer clean technologies to the developing world on concessionary terms. On September 22, 2009, in his speech to the UN, Hu Jintao elaborated a bit on this basic position saying, 'We will endeavor to cut carbon dioxide emissions per unit of GDP by a notable margin by 2020 from the 2005 level'. That is, the Chinese envision a situation in which they would become progressively more energy/carbon efficient (and that would help prevent even faster CO₂ buildup), but they likely would be emitting growing absolute volumes of CO₂ for at least some period of time.⁶⁹ Indeed, Mark Levine of Lawrence Berkeley National Laboratory argued as early as 2000 that,

If energy [consumption in China] had grown at the same rate as GDP after 1980—a rate that would have been a marked improvement on the past and one that was lower than almost all other developing countries—energy use in 2000 would have been more than twice its actual value [in 1997]. And carbon emissions, the major greenhouse gas, would have been twice actual levels as well.⁷⁰

68. It is true that the Supreme Court has empowered the Environmental Protection Agency to regulate CO₂ as a pollutant hazardous to public health and welfare, but were such action to be taken by a regulatory agency on a substance so fundamental to the economy in the face of bipartisan, bi-cameral opposition of the legislature, that would be incredibly expensive politically and perhaps politically unsustainable.

69. There has been insufficient appreciation of how much China has contributed to management of CO₂ emissions below the levels that would have been reached in the absence of energy intensity reductions per unit of GDP. See Mark Levine, 'Energy and environment in China: a harbinger of China's future', in Dick Clark, ed., *US–China Relations, Third Conference on US–China Relations*, 30 May–3 June 2000, The Aspen Institute, 15(4), (2000), pp. 29–39.

70. *Ibid.*, p. 32.

The Chinese argue that their efforts to increase energy efficiency are helpful and considerations of equity require that they be considered, given that the per capita emissions of Chinese citizens are far lower than those of Americans—in 2005, the United States emitted 20 metric tons of CO₂ per capita and China only four.⁷¹ The contours of a possible deal are that Beijing makes commitments to increased energy efficiency during some transitional period and the United States makes commitments to CO₂ reductions. Joint technology development and R&D are also likely to be part of the mix. This is easy to articulate, but difficult to accomplish politically in both China and the United States. Just the terms of technology transfer and the implications for intellectual property rights are huge stumbling blocks. Also, there is an underlying tradeoff between efforts at CO₂ reductions and resources devoted to adaptation to what presumably is the inevitable global warming that the planet already faces.⁷²

To the US Congress, were the United States to make a substantial absolute carbon emissions reduction commitment, and accept energy/carbon intensity reductions as the Chinese quid pro quo, this would create the difficult political reality that US emissions would be dropping as Chinese emissions were rising. Put simply, that would be a hard sell in the United States and perhaps in other advanced industrial societies as well. As Representative Rogers of Michigan put it when talking about proposed cap-and-trade legislation in Congress: ‘Do not eliminate our middle class and send it to China and India’.⁷³ Even more pointedly, a nearly full-page advertisement in the *Washington Post* put it as follows: ‘This trade cheating [by China] has helped China to amass an astonishing US\$1.5 trillion in US currency reserves. And now they want us to pay to clean up their dirty factories?’⁷⁴ If such a deal were to be politically possible it implies a US president willing and able to burn a lot of political capital with Congress. Whether or not this hard political nut can be cracked, there are many other avenues of Sino–American cooperation as specified in *A Roadmap for US–China Cooperation on Energy and Climate Change*⁷⁵ that can and should be pursued.

Beyond the issue of the mandatory or voluntary character of standards, and what those standards might be, there are further issues concerning the means by which such targets might be achieved—cap-and-trade, carbon tax, or other means or combinations of means, including a clean development mechanism involving cross-border carbon permit trading. Each of these possible mechanisms will be the subject of enormous pulling and hauling within China and the United States themselves and between them.

71. Energy Information Administration, Department of Energy, ‘Carbon dioxide emitted per capita’, available at: http://tonto.eia.doe.gov/ask/environment_faqs.asp (accessed 18 May 2009). In 2006, China was at about 4.4 tons per capita and the United States at 19.8, according to William Chandler, ‘Breaking the suicide pact: US–China cooperation on climate change’, Carnegie Endowment for International Peace, (May 2008), p. 3.

72. Wang Zonglei, ‘Tackling climate change: a scientific view of development’, *Contemporary International Relations* 19, (March 2009), pp. 68–88.

73. David A. Fahrenthold, ‘Cap-and-trade debate drags on in House Energy Committee’, *Washington Post*, (20 May 2009), p. A3.

74. US Business and Industry Council, *Washington Post*, (21 May 2009), p. A20.

75. Pew Center on Global Climate Change and The Asia Society, *A Roadmap for US–China Cooperation on Energy and Climate Change*, especially pp. 6–8.

In the absence of an agreement between China and the United States, there has been some talk in the United States that one option would be to impose a ‘carbon tax’ on the imports from countries not undertaking what the United States may construe as their responsibilities in the global warming arena. This, of course, would be seen as a very threatening restraint of trade in Beijing (and elsewhere), in turn setting off a series of unwelcome reactions.

The point is not that there is no overlapping win set—rather, the point is that it is going to be very hard to find an overlapping win set that is politically sustainable in both societies and effective at addressing this threatening problem. Part of a possible win set would be identified around China’s need and desire to rebalance its economy away from investment-intensive, energy-intensive heavy industry more toward light industry, services, energy efficiency, and cleaner coal and other technologies. If Beijing can do this, this would have multiple positive payoffs for climate change, domestic health and environment issues, and the consumption level of the Chinese people.⁷⁶ Beyond that, there are many opportunities for joint technology research, design, development, and testing in areas as diverse as new building codes to carbon sequestration.

A ‘new’ global economic architecture and protectionist fears

The post-World War II Bretton Woods system, and most of what we associate with the post-World War II structure of the international economic system, has fostered an environment in which world trade (not to mention finance) grew at rates far higher than world trade grew from 1870 to 1950. This expansion promoted development in much of the world. The United States and Europe have been the predominant voices in the leadership of the International Monetary Fund (IMF) and the World Bank and the United States dollar has been the premier reserve currency as well as a currency of settlement, facts from which the United States has derived enormous advantage. Attractive dollar-denominated US Government assets have lowered borrowing costs for Americans and permitted higher government spending and higher consumption levels in the United States than would otherwise have been the case over the last 60 years. But now, holding perhaps US\$1.6 trillion in US dollar-denominated assets, Beijing cares deeply about the management of the US dollar (and economy) and fears that the United States will be driven to inflate it, paying its debts back with cheapened currency.

In light of all this, the following close paraphrase of remarks made to me by a senior finance official in the spring of 2009 indicate where I believe Chinese thinking and policy is heading:

We are still living in a dollar-denominated world. [In 1971] the dollar was delinked from gold. It now is 64% of [China’s] reserves, 64% of our trade. It is 68% of the settlement of world trade. This can’t change for a long time. The world needs a diversified currency structure. The euro is not good to balance the dollar, or the yen—the yen is too passive ... So, only the RMB can balance the dollar, but [that] takes time. Glad to see it

76. In this regard, see, C. Fred Bergsten, Charles Freeman, Nicholas R. Lardy and Derek J. Mitchell, *China’s Rise: Challenges and Opportunities* (Washington, DC: Peterson Institute for International Economics and the Center for Strategic and International Studies, 2008), ch. 7.

[the RMB] used more in the world. So, use it more in the region. For many companies, the RMB is the most stable and exchange rate risk is less. The next step beyond swaps is lines of credit in RMB.

If the above quote is not clear enough, in March 2009 People's Bank of China Governor Zhou Xiaochuan called for 'creative reform of the existing international monetary system towards an international reserve currency with a stable value, rule-based issuance and manageable supply, so as to achieve the objective of safeguarding global economic and financial stability'.⁷⁷ It is not only the Chinese who worry about a devalued dollar and what this implies for their stock of US dollar denominated assets; holding RMB assets is becoming one 'hedge' against the dollar, with Malaysia's Central Bank seeking to invest more in Chinese Government debt 'as a secure reserve'.⁷⁸

Turning to institutional issues, with respect to its future role in the IMF, for instance, Beijing already is demanding more voice than its current 3.6% share of organization votes in return for helping to fund IMF initiatives to assist countries with liquidity problems. The United States (with its 16.7% of IMF voting shares) seems ready to accommodate an expanded PRC role—how much expanded is unclear.⁷⁹ This question of adjusting China's voice in organizations in which it already has membership, and according it membership in those in which it currently is not a member (e.g. the International Energy Agency, an autonomous agency linked to OECD with 28 members), only will be asked with increasing frequency as China's objective and comprehensive strength in the global economic system increases.

As the world edges toward an at least somewhat different system, one can expect the United States to try to protect its current dominance and advantages, as will Europe, where the Continent's smaller nations may suffer relatively more eclipse.⁸⁰ The degree to which China and the United States will be on opposite sides remains to be seen, but the potential for disagreement over specifics is substantial. China was not invited into full membership of the G-7 for so long that this issue is hardly any longer relevant, given the decline of the G-7 itself and what seems to be the ascendant role of the G-20, of which China is a prominent member.

Beyond the issues of management of the dollar and equitable roles in global multilateral economic institutions there is the increasingly complex world of transnational trade and finance. The combination of more complex, larger, and more interlinked financial institutions and financial instruments, along with the glaring regulatory weaknesses the current global downturn has exposed, is giving rise to

77. Zhou Xiaochuan, 'Reform the international monetary system', available at: <http://www.pbc.gov.cn/english/detail.asp?col=6500&tid=178> (accessed 23 April 2009).

78. Denis McMahon, 'Malaysia looks to invest in China', *WSJ.com*, (22 June 2009), available at: <http://online.wsj.com/article/SB124561706240235209.html> (accessed 24 June 2009).

79. Tim Geithner, 'Prepared statement by Treasury Secretary Tim Geithner at the G-20 Finance Ministers and Central Bank Governors Meeting', available at: <http://www.treas.gov/press/releases/tg56.htm> (accessed 20 May 2009); see also, Joe McDonald, 'Obama, Hu stress crisis response in first meeting', *Associated Press*, available at: <http://www.google.com/hostednews/ap/article/ALeqM5jzzULJt2ZiW2lZR3KKuViEpbOA1QD97A5AO80> (accessed 2 April 2009); also, Anthony Failoa, 'A bigger, bolder role is imagined for the IMF', *Washington Post*, (20 April 2009), pp. A1 and A12.

80. Andrew Batson, 'The G-20 Summit: China seeks more involvement—and more clout—developed nations watch warily as Beijing, with vast foreign-exchange reserves, upgrades role in global affairs', *Wall Street Journal*, (31 March 2009), p. A10.

demands by emerging big world actors that they have more influence in the process by which rules and regulations are established to manage often private or quasi-private institutions.⁸¹ Beijing feels, as does its increasingly resentful citizenry that is pushing Chinese leaders on this issue, that an insufficiency of regulation of Western financial institutions allowed asset bubbles to form in the United States and elsewhere, permitted the creation of financial instruments the value of which were impossible to gauge, and allowed the expansion of comprehensive financial corporate leviathans that were hard to responsibly manage, not to mention permitted a situation to arise in which private sector ratings watchdogs ultimately were in bed with those they were charged with regulating. The president of the China Investment Corporation, Gao Xiqing, put it bluntly: 'If you look at every one of these [derivative] products, they make sense. But in the aggregate, they are bullshit. They are crap. They serve to cheat people'.⁸² Deputy People's Bank Governor Hu Xiaolian put it more diplomatically in March 2009: 'Under the current situation, we feel that the IMF particularly needs to strengthen its surveillance of the economic policies and financial policies of the major reserve-currency-issuing nations'⁸³ (read the United States, the Euro Zone, Britain, and Japan). As *Xinhua* put it in June 2009, 'The financial crisis, as many have known, is a result of ill-advised macroeconomic policies by some advanced economies and their failure to enforce vigorous regulation over the ever growing financial industry'.⁸⁴

All this suggests what should have been obvious for a long time. China is thinking about its trade and finance role in global terms and the question in this realm, as in many others, is: how will the US react both in terms of its external policies and its internal readjustments? Even under the best of circumstances, the necessary readjustments in both nations will not be easily accomplished.

Beyond these fundamental institutional, currency, and regulatory issues, the current drop in global trade volumes (17.5% from November 2008 to January 2009⁸⁵) raises the issue of protectionism inasmuch as every country wants to boost (or at least maintain) exports and domestic constituencies put pressure on their politicians to minimize the competition from imports. Consequently, China has used value-added tax rebates to help boost exports in key sectors (which is a WTO-compatible practice) and some would say the Ministry of Commerce has used new anti-monopoly and competitiveness legislation to prevent foreign firms from acquiring Chinese entities, as was the case with Coca-Cola's attempt to acquire Huiyan Juice Company.⁸⁶ China has used its Postal Law (claiming security considerations) to limit the operations of foreign express package delivery firms in China with respect to domestic-only shipments,⁸⁷ and National Development and Reform Commission procurement

81. Wang Qishan, 'G20 must look beyond the needs of the top 20', *Times Online*, (27 March 2009), available at: http://www.timesonline.co.uk/tol/comment/columnists/guest_contributors/article5982824.ece (accessed 20 May 2009).

82. Fallows, 'Be nice to countries that lend you money'.

83. Batson, 'The G-20 Summit', p. A10.

84. Ming Jinwei, 'Meeting of BRIC leaders set to promote cooperation among each other'.

85. CPB Netherlands Bureau for Economic Policy Analysis, 'World trade volume', (21 April 2009).

86. 'Coca-Cola: acquisition of Huiyan Juice Group in China not to proceed', available at: http://www.finchannel.com/index.php?option=com_content&task=view&id=32198&Itemid (accessed 6 May 2009).

87. 'Group says China's new postal law restricts market access', *Associated Press*, (24 April 2009).

policies discriminate in favor of Chinese producers, particularly on government stimulus package projects, apparently in some cases even discriminating against foreign-invested enterprise suppliers in China itself. On the American side, there was in the past resistance to the acquisition of some US firms by Chinese interests, most notably CNOOC's 2005 squelched attempt to acquire Unocal⁸⁸ and another Chinese acquisition attempt (by Huawei) aimed at 3Com.⁸⁹ Similarly, 'The US has held back approval of banking licenses for China's two biggest banks because of concerns over the role of China's sovereign wealth fund as their largest shareholder ...'.⁹⁰ Both sides, of course, see each other's activities as the incubus of protectionism.

Conceptually more troubling, with most states playing greater roles in their domestic economies with 'stimulus packages', it is becoming difficult to tell 'stimulus' from subsidies and blatant attempts to prop-up non-competitive industries. Each of our two countries wants to boost exports to the other while simultaneously minimizing import competition that injures important domestic constituencies. These conflicting impulses create frictions, seen in US 'buy American' provisions in the 2009 US stimulus package. We are moving into a world in which the steel and auto industries in the two countries will be major forces pushing for more protection, disguised or open. Perhaps the real surprise is not the current protectionist pressures in both countries, but rather their thus far subdued and marginal scale, with even the 'buy-American' provisions of the stimulus legislation of 2009 weakened by escape clauses and the stated intention to be WTO-consistent.

Dealing with counter-proliferation, failed states, and mutual strategic mistrust

China is situated in a tough and complicated neighborhood, whether one looks at it from the viewpoint of failed states on its periphery that could spill their problems into China (the Democratic People's Republic of Korea [DPRK], Afghanistan, and increasingly Pakistan) or from the vantage point of nuclear proliferation, which has recently occurred, or is within sight, in North Korea, Pakistan, and Iran. Each of these societies is one with which China has relatively close relations but which, in the current context, present more and more problems for Beijing. Because China has considerations in dealing with each of these problematic cases that the United States does not have, it is unsurprising that the United States and the PRC often have different preferences concerning how to concretely deal with the problems emanating from each. In each of these cases, the Chinese have perceived a United States more predisposed to employ coercive means (force or sanctions) than they feel comfortable with. Moreover, the PRC simply does not like the implication of a forward US military presence around its near-in periphery which a coercive US response to these regional problems implies. The operational code of Chinese leaders is that it is easier to make things worse than to improve them and that the United States has too short

88. Francesco Guerrera, Joe Leahy and James Politi, 'CNOOC drops its dollars 18.5bn Unocal bid', *Financial Times*, (3 August 2005), p. 1.

89. Richard McGregor, James Politi and Richard Waters, 'Huawei-3Com deal finally collapses amid US opposition', *Financial Times*, (22 March 2008), p. 9.

90. Jamil Anderlini, Geoff Dyer and Krishna Guha, 'US delays licenses for China's biggest banks', *Financial Times*, (17 June 2008), p. 10.

a time horizon for 'solving problems'. Underneath it all, Chinese leaders are less concerned (though they say the right things) about nuclear proliferation and terrorism than is the United States.

Consequently, one finds that while the Chinese oppose North Korean nuclear and missile system developments and testing, such as those seen in May 2009, and while Beijing has upon occasion applied pressure to get Pyongyang to the negotiating table, it is nonetheless willing to live with a North Korea moving toward more and more nuclear and delivery capabilities, as long as the North Koreans also will not light the fuse to actual hostilities that genuinely would threaten core Chinese interests, namely stability in the northeast of the PRC. Negotiations and stability are Beijing's real measures of success, not absolutely eliminating nuclear weapons on the Korean Peninsula. Beijing would like the latter, but it will settle for the former. This was evident, once again, in the three-week-long UN Security Council discussions over new sanctions on Pyongyang in the wake of the May 2009 nuclear test. Beijing, as did Moscow, eventually went along with tougher sanctions than ever before, but none that would really threaten regime stability in North Korea. Each seemingly tough sanction has some clause that softens its potential impact, at least in terms of the requirement for specific tough action by Beijing.

In the longer term perspective, Beijing believes that only economic development along a trajectory similar to China's own in the era of reform offers the real prospect for a new and more constructive North Korean role in the international system. So, since at least 1992, we have seen a Beijing and Washington that agree about broad principles but differ over concrete means, with the result that while occasionally Beijing, Washington, Seoul, Moscow, and Tokyo (as well as the UN Security Council) can agree on slapping Pyongyang's wrists, North Korea steadily has acquired its own nuclear warheads and increasing delivery capabilities. North Korea quite apparently is committed to keeping its nuclear arsenal, will pay the prices necessary to do so, and Beijing will not knowingly threaten the Pyongyang's regime stability, all the while being supremely frustrated by North Korean actions and trying to get the DPRK back to the negotiating table.

The acid test of Beijing from an American interest point of view will be whether or not Beijing inspects North Korean shipments over and on its territory. If North Korea is able to sell and proliferate nuclear materials, equipment, and delivery systems using Chinese air space or land routes, and an untoward event occurs, this could prove ruinous to bilateral ties. If China does not react to continued North Korean provocation one has to suppose the South Koreans and the Japanese will begin to ask themselves questions, the answers to which Beijing might not like.

In Afghanistan, Beijing feels uncomfortable with even the remote prospect of a Taliban return to power, fearing the contagion of Islamic extremism on its periphery and seepage into China's own western regions. But, China's ruling elite also feels uncomfortable with a heavy US presence in Afghanistan and does not want its border with Afghanistan used as a transit point for the NATO effort (even using civilian resources) given the Western presence it would imply in its own sensitive western areas and the interventionism it would facilitate. China is willing to contribute some development assistance to rebuilding Afghanistan (but prefers to do so bilaterally, not in close cooperation with Washington or others), but ultimately remains unconvinced

that the war can be won militarily and does not wish to see a permanent US presence there. Consequently, Beijing always will be a reluctant and cautious interlocutor when it comes to the Afghan War, beyond less controversial development assistance and cooperation that may be largely invisible to the outside world.

And with respect to Pakistan, China's close partner of longest standing in the region, the US posture of attacking Al Qaeda- and Taliban-controlled border areas in the regions of Pakistan beyond the writ of the central government in Islamabad, is worrying to Beijing. Beijing's inclination is to safeguard its special relationship with Pakistan and to see such US efforts as contributing to further instability, instability that could weaken the central government in Islamabad, catalyze further breakdown of a massive (nuclear) state on China's borders, and induce co-religionists to cross the China-Pakistan border into periodically turbulent areas of the PRC itself (e.g. the area around Hotan in the Kunlun Mountain region of Xinjiang). Consequently, Beijing seems inert as extremists are moving to build strongholds in the central cities of Pakistan as well, meaning that in this area as so many others, Beijing is uncomfortable with American policies but really has no alternative plan behind which it is prepared to put muscle.

In short, China and Washington share the desire for stable states on the PRC's borders, as well as the restoration of order and a focus on economic and social development in these societies, but the two capitals often will not agree on the concrete measures needed to achieve these objectives. Washington finds Beijing reluctant to be identified with US measures regarding these states, and this will be a source of frustration to any US administration looking for more active PRC cooperation. Beijing's priority on domestic economic development provides it with the ever-ready framework for deferral, saying domestic development now, and stability on the periphery. This could be no clearer than in Burma where the United States and much of the West pushes for sanctions and the Chinese are reluctant to go along, preferring to reap the energy and commercial benefits of doing business with its southern neighbor, much as India does.

Turning to the broader issue of China's growing power projection capability, China's air, naval, cyber, and space power projection capacities are growing; this is pushing the People's Liberation Army (PLA) increasingly into domains that were (and generally remain) dominated by US power.⁹¹ We see this in: the ongoing speculation (which I believe to be true) that China will acquire aircraft carrier capabilities;⁹² the January 2007 shoot-down of an aging satellite; the construction of a nuclear submarine base on Hainan Island;⁹³ the 2009 public unveiling of its newest nuclear ballistic missile-capable submarines; Beijing's January 2009 dispatch of naval forces to the Gulf of Aden on anti-piracy duty;⁹⁴ several Spring 2009 maritime

91. Ke Ji, 'The development trend of world military science and technology', *International Strategic Studies* no. 2, (2009), pp. 1–8.

92. 'Aircraft carrier project', available at: <http://www.globalsecurity.org/military/world/china/cv.htm> (accessed 5 May 2009); see also, 'China reportedly to build first aircraft carrier', *Hong Kong Ming Pao*, in Chinese, (12 January 2000), p. A15. Indeed, a senior Chinese military officer with whom I spoke in the 1990s made it clear that it might take two decades but China would acquire aircraft carriers—after all, India had them.

93. Richard D. Fisher, Jr, 'Secret Sanya—China new nuclear naval base revealed', *Jane's Intelligence Review*, (21 April 2008).

94. Li Minjiang, 'China's Gulf of Aden expedition: stepping stone to East Asia?', *RSIS Commentaries*, (9 January 2009).

incidents between US Navy and Chinese civilian vessels operating in international waters (and also simultaneously in China's Exclusive Economic Zone),⁹⁵ an 'inadvertent encounter' between a Chinese submarine and a US destroyer off the Philippines in June 2009; broader developments in its aircraft and other military-related industries and civilian technological base;⁹⁶ and protracted and systematic China-based attacks on sensitive US computer systems and networks which is eliciting a vigorous counter response from Washington.

The point is not that all this is a precursor to open conflict (though sea incidents have such potential), but rather to signal that rules of the road on the seas, in the air, space, and cyber space need to be worked out (or reaffirmed) and ways must be found to channel the energies of two sets of defense-related establishments in constructive directions, such as humanitarian and other joint missions. This will not be easy under the best of circumstances; and, the United States will need to come to terms with its ambivalence between the thought that increased Chinese capabilities could be helpful (e.g. anti-piracy duty, humanitarian missions, and air and sea rescue) and the anxiety that China's growing strengths are almost by definition not in US interests. The US is at war with itself over whether or not it really wants China to be a 'joint security provider' and China is at war with itself over whether or not, and how rapidly, to assume such burdens.

Taiwan and Tibet

Taiwan has been a chronic, sometimes intense, issue between the United States and China that currently is moving in a positive direction, with increased cross-Strait interaction and talk of economic and other cooperation, including a gradual increase in cross-Strait investment in property and financial institutions.⁹⁷ Most encouraging is the prospect that the two sides of the Strait can begin to negotiate an Economic Cooperation Framework Agreement (ECFA) in the not-too-distant future⁹⁸ and perhaps further out on the horizon is the possibility of some form of 'peace agreement' that would stabilize the security situation in the Strait, even if it did not fully resolve all current cross-Strait issues.

The jobs of Washington and Beijing will be to do what they respectively can to keep the momentum moving in a positive direction. The United States continually will be pushing Beijing to do more to 'win the hearts and minds' of the Taiwan people (such as reducing the still-growing missile threat and providing more opportunities to participate in the global arena). Beijing took such welcome initiatives when it agreed to Taipei's May 2009 participation in the annual meeting of the World Health Assembly and initiated the at least temporary cessation in the competition between Beijing and Taipei for the recognition of states. On the other hand, Beijing will continually seek to have the United States lessen its security involvement with the

95. Ben Blanchard, 'China says "concerned" by US naval incident', *Reuters*, (6 May 2009).

96. Evan S. Medeiros, Roger Cliff, Keith Crane and James Mulvenon, *A New Direction for China's Defense Industry* (Santa Monica: RAND, 2005).

97. Jane Rickards, 'Taiwan, China to meet for talks this weekend', *Washington Post*, (24 April 2009), p. A12.

98. Ma Ying-jeou, 'The Taiwan Relations Act: turning a new chapter', delivered via video link, Center for Strategic and International Studies, Washington, DC, (22 April 2009), p. 4.

island, most notably as expressed by US weapons sales to Taipei. How the United States can do enough for Taiwan President Ma Ying-jeou in the security realm to keep him credible with his own people in a security sense (and inspire confidence in the US Congress that the Administration is doing what it should under the Taiwan Relations Act), without undermining PRC willingness to continue to relax tensions across the Strait and cooperate with Washington in other important domains, is the tightrope that must be walked. In video remarks delivered to the Center for Strategic and International Studies on 22 April 2009, President Ma Ying-jeou said that, 'I urge the United States to not hesitate to provide Taiwan with the necessary defensive arms as stipulated in the TRA [Taiwan Relations Act]'.⁹⁹

Turning to the Tibet issue, the Dalai Lama will be coming to Washington in late 2009 and possibly 2010, raising the issue of how the new Administration will square its many interests with Beijing with the domestic political and moral imperatives to treat his Holiness with dignity as a religious leader. Beijing is particularly anxious about developments on the Tibetan Plateau and will probably exert a full court press on the Obama Administration to keep any visit as low key as possible.

Concluding thoughts

The US–China relationship is fundamentally more stable than it has ever been. This is so because power is more equally distributed between them and each needs to cooperate with the other to address problems it deems critical to its own future. The common necessities of the United States and China have made them hostage to each other and, in many respects, competitors, principally in the economic and intellectual domains. This world is not to be feared inasmuch as America's diversity and inherent innovative capacity confer advantages; but Americans need to rediscover and intelligently deploy these advantages. The vision that should guide the two nations going forward is one of partnership in building the coalitions necessary to address the challenges of global economic, environmental, and security stabilization.

China is a prominent stakeholder in the international system. The question now is what burdens is China able and willing to assume to enhance and maintain that system? In many circumstances the 'responsible course' may be unclear and what constitutes a 'fair' distribution of burdens is not self-evident. In short, it will be difficult to produce the cooperation that the 'fierce urgency' of the present requires.

99. *Ibid.*, p. 7.

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