



# CRITICAL ISSUES CONFRONTING CHINA

## Seminar Series

SUMMARIES OF TALKS

Fall 2015-Spring 2016

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THE HARVARD UNIVERSITY ASIA CENTER AND  
THE FAIRBANK CENTER FOR CHINESE STUDIES  
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**Critical Issues Confronting China** is a public weekly seminar series, organized by Professor Ezra F. Vogel, Professor William Hsiao, and Dr. William Overholt, which was inaugurated in September 2013. Made possible with support from the Lee and Juliet Folger Fund, the series is co-sponsored by the Harvard University Asia Center and the Fairbank Center for Chinese Studies.

The purpose of the series is to consider the complex issues China is presently facing and to look at the range of choices Chinese leaders might consider when responding to the challenges and opportunities they confront. The topics and perspectives have been diverse and wide-ranging, including domestic issues like urbanization, economic slowdown, management of dissent, environmental damage, and relations with various parts of the world. As before, the series is organized to promote informal exchange among senior specialists and questions from and discussion with an engaged and committed audience.

The summaries presented here are from the third year of the seminar series, beginning in September 2015 and ending in April 2016. They were written by Jin Chen, a graduate of the Regional Studies-East Asia (RSEA) program at Harvard and an Associate in Research at the Fairbank Center. Michelle Blouin, Mary Dethavong, and Tenzin Ngodup of the Harvard Asia Center provided editorial support. Holly Angell, Associate Director of the Harvard Asia Center, was the overall administrator for the series.

# Critical Issues Confronting China

## Fall 2015-Spring 2016 Speakers

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### **Wednesday, September 9, 2015**

IS AN ERA OF GEOPOLITICS REPLACING AN ERA OF PEACEFUL ECONOMIC OBSESSION?

Dr. **William Overholt**, Senior Fellow, Harvard University Asia Center

### **Wednesday, September 16, 2015**

ASSESSING THE PROSPECTS FOR XI JINPING'S LEADERSHIP

Dr. **Paul Heer**, Robert E. Wilhelm Fellow, MIT, Center for International Studies; former National Intelligence Officer, East Asia

### **Wednesday, September 23, 2015**

CHINA, THE MIDDLE EAST, AND BEYOND

**Ambassador Chas W. Freeman, Jr.**, Senior Fellow, Watson Institute for International Studies, Brown University; former Assistant Secretary of Defense for International Security Affairs; former U. S. Ambassador to Saudi Arabia; former Principal Deputy Assistant Secretary of State for African Affairs; former Deputy Chief of Mission and Chargé d'affaires in the American embassies in Bangkok and Beijing; and former Director for Chinese Affairs at the U.S. Department of State

### **Wednesday, September 30, 2015**

XI JINPING'S VISIT TO THE UNITED STATES

**Professor Ezra Vogel**, Henry Ford II Professor of the Social Sciences Emeritus, Harvard University

### **Wednesday, October 14, 2015**

CHINA IN THE WORLD ECONOMY: THE NEW NORMAL

**Edwin Lim**, China Economic Research and Advisory Programme; former CEO of the China International Capital Corporation (CICC); former economist for The World Bank; former director of The World Bank's China office

### **Wednesday, October 28, 2015**

URBANIZATION AND THE FUTURE OF CHINA

**Professor Meg E. Rithmire**, Assistant Professor, Business, Government, and the International Economy Unit, Harvard Business School

**Wednesday, November 4, 2015**

URBANIZATION WITH CHINESE CHARACTERISTICS: CHINA'S NATIONAL PATTERNS IN INTERNATIONAL PERSPECTIVE

**Nicholas Eberstadt**, Henry Wendt Scholar in Political Economy, American Enterprise Institute**Wednesday, November 18, 2015**

CHINA'S ECONOMIC REBALANCING CHALLENGES

**Guonan Ma**, Senior Fellow, Fung Global Institute; non-resident Fellow of Bruegel, the Belgian think tank; former Senior Economist at the Bank for International Settlements**Wednesday, December 2, 2015**

CHINA AND ASEAN: THE CRITICAL ISSUES

**Professor Arne Westad**, S.T. Lee Professor of U.S.-Asia Relations, Harvard Kennedy School**Wednesday, December 9, 2015**

Book Talk

WILL AFRICA FEED CHINA?

**Professor Deborah Brautigam**, Author; Bernard L. Schwartz Professor in International Political Economy; Professor of International Development and Comparative Politics; Director of International Development Program and China-Africa Research Initiative, School of Advanced International Studies (SAIS), Johns Hopkins University**Friday, February 5, 2016**

SINO-RUSSIAN RAPPROACHEMENT

**Alexander Lukin**, Department Head, Faculty of World Economy and International Affairs, School of International Affairs, National Research University Higher School of Economics, Moscow**Wednesday, February 10, 2016**

Book Talk

RENMINBI RISING: A NEW GLOBAL MONETARY SYSTEM EMERGES

**Dr. William Overholt**, Senior Fellow, Harvard University Asia Center**Wednesday, February 17, 2016**

THE TAIWAN ELECTIONS AND CROSS-STRAIT RELATIONS: WHAT NEXT?

**Professor Steven M. Goldstein**, Sophia Smith Professor of Government, Smith College; Associate, Fairbank Center**Wednesday, February 24, 2016**

CHINA AND THE U.S. REBALANCE TO ASIA: RECENT RESEARCH ON BEIJING'S RELATIONS WITH AUSTRALIA, INDONESIA, MYANMAR, AND VIETNAM

**Dr. Bates Gill**, Professor of Asia Pacific Strategic Studies, Strategic and Defence Studies Center, Australia National University

**Wednesday, March 2, 2016**

THE TRANS-PACIFIC PARTNERSHIP AND ITS IMPLICATIONS FOR CHINA

Professor Mark Wu, Harvard Law School

**Wednesday, March 9, 2016**

CHINA AND GLOBAL FINANCIAL MARKETS: A CLASH OF CIVILIZATIONS?

Dr. Scott Kennedy, Deputy Director, Freeman Chair in China Studies; Director, Project on Chinese Business & Political Economy, Center for Strategic & International Studies (CSIS)

**Wednesday, March 23, 2016**

THE CHANGING DYNAMICS OF U.S.-CHINA RELATIONS AND THE FUTURE OF AMERICA'S CHINA POLICY

Dr. Evan S. Medeiros, Managing Partner, Eurasia Group; former Senior Director for Asia, U.S. National Security Council

**Wednesday, March 30, 2016**

WHITHER CHINA'S ECONOMY

Pieter P. Bottelier, China Studies Visiting Scholar, School of Advanced International Studies (SAIS), Johns Hopkins University

**Wednesday, April 6, 2016**

SCIENCE AND TECHNOLOGY IN THE MAKING OF MODERN CHINA: FROM GIST GEE TO DR. TU YOUYOU

Professor Lawrence Sullivan, Adelphi University

Dr. Nancy Liu-Sullivan, College of Staten Island

**Wednesday, April 13, 2016**

Book Talk

STRATEGIES FOR INNOVATION IN CHINA

George S. Yip, Professor of Strategy and Co-Director, Centre on China Innovation, China Europe International Business School (CEIBS); Professor of Marketing and Strategy, Imperial College Business School, London

Bruce McKern, Visiting Research Fellow, the Saïd Business School, University of Oxford; former Co-Director, Centre on China Innovation, CEIBS

**Wednesday, April 20, 2016**

A HIMALAYAN CONSENSUS: WHAT INDIA AND CHINA COULD DO

Ambassador Nirupama Rao, Senior Fellow in International and Public Affairs, Brown University; former Foreign Secretary of India; former Ambassador of India to China and the United States

**Wednesday, April 27, 2016**

REPORTING FROM CHINA

David Barboza, Former Shanghai Bureau Chief, *The New York Times*; winner of the 2013 Pulitzer Prize for international reporting

# IS AN ERA OF MILITARY GEOPOLITICS REPLACING AN ERA OF PEACEFUL ECONOMIC OBSESSION?

**Dr. William Overholt**

Senior Fellow, Harvard University Asia Center

**September 9, 2015**

Since World War II, Asia has experienced one of the greatest periods of regional peace (despite local conflicts) and the greatest expansion of prosperity in world history. Dr. William Overholt attributed this period of peace and prosperity to two changes. One is that the world discovered that a country could become a rather big power by growing seven to ten percent per year and that rapid economic growth would stabilize domestic politics as people focused on improving their living standards. The other is that military technology became so destructive and military combat had become so disruptive and unpleasant to contemplate that the world basically followed an economics-focused strategy with military prowess playing only an auxiliary function of protecting the economic order.

Several examples illustrate this point. Japan became a big power in the three decades after World War II with only negligible military. South Korea surpassed North Korea in all respects by prioritizing economic development over military buildup under General Park Chung Hee. Indonesia became a clear regional leader under General Suharto by abandoning territorial claims to most of Southeast Asia and focusing instead on economic development. Last but not least, China under Deng

Xiaoping's leadership compromised some land disputes and slashed the military budget while concentrating its energies to catch up with other countries economically.

The success of these countries has an economics focus at its core. The U.S. utilized an economics-focused strategy after World War II. It helped re-build western Europe and Japan by providing substantial economic aid, created various development programs around the world to share technology and prosperity, and supported the three pillars of international order of the day, namely the International Monetary Fund (IMF), the World Bank and the General Agreement on Tariffs and Trade (GATT; later to become the World Trade Organization [WTO]). Unfortunately, this economics-focused strategy was abandoned in 2001, when all major foreign policy positions in the George W. Bush administration were held by defense specialists, many of whom were contemptuous of civilian programs. Military priorities dominated with the advent of the Iraq war. Congress has continually squeezed economic and diplomatic efforts while, because of powerful lobbies, generously funding the military.

Overholt criticized realist theories, which argue that military conflict is highly probable between a rising power and an established power. These theories implicitly assume that any competition for power is focused on military struggle. They refuse to address the possibility that conditions have changed since World War II.

He explained how the major Asian powers—China, Japan, and the U.S., abandoned at the turn of the 21st century the economics-focused strategies, and embarked on a zero-sum game of military competition

Continued on page 6

Continued from page 5

and geopolitics. He rebutted the realists' conclusion that China's economic growth should be scuppered in order to prevent it from becoming a regional hegemon. He argued instead that not only China should be included in various economic and trade negotiations, but the U.S. should join China's efforts in connecting the world through trade and economic development; that is, to return the world to its previously successful strategy of the positive-sum game of economics.

Overholt analyzed how each country in turn abandoned economics-focused strategies and overemphasized geopolitics. In addition to putting defense experts in charge of foreign policy during the George W. Bush administration, the U.S. employed misguided economic policies. A Congress consisting of less cosmopolitan legislators opposed reform plans to modernize the IMF and World Bank by recapitalizing and shifting voting rights to reflect the new world economy of the 21st century. This incentivized China to establish new international institutions such as the Asian Infrastructure Investment Bank (AIIB). However, the U.S. refused to join the AIIB, to which more than 50 countries have signed up. Furthermore, instead of supporting the WTO, the U.S. is pursuing other regional free trade frameworks such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP), which exclude China on the ground that China is not ready for the high standards of these trade talks. But this excuse does not hold water, according to Overholt. Japan is much less open than China, and Vietnam is much less developed than China in many ways, but both of them are included in the TPP.

Overholt also criticized Japan for being on the wrong path in recent years. Instead of focusing on the third arrow of Abe-nomics (i.e., structural reforms), Prime Minister Abe uses more of his political capital on constitution revision and territorial disputes with its neighbors. By purchasing the Senkaku/Diaoyu Islands, Japan destroyed an agreement that had kept the peace for four decades.

Likewise, China, starting from the Hu Jintao era around 2005, began to respond to pressures of national security and upset many of its neighbors. It has also moved away from the economics-focused strategy, which was so successful under Deng Xiaoping. To Overholt, a military equilibrium is replacing a diplomatic equilibrium in Asia. On the South China Sea dispute, Overholt acknowledged that China is not doing anything different from any other claimants; the only difference is that China's extraordinary size draws more attention to its actions. But China has harmed its own interests, consolidating a U.S.-led alliance of all its maritime neighbors against it, delaying exploitation of the region's resources, and reducing regional support for its claim to Taiwan.

In this distressing world of increasing geopolitical tension, Overholt saw hope in China's "One Belt and One Road" project, not only because this project represents a vision analogous to the successful economics-focused strategy the U.S. successfully adopted after World War II, but also because it offers a coherent strategy for the world to contain explosions of violence and extremism in the Middle East and North Africa that endanger global stability. China's dual silk road project—both land and

Continued on page 7



Continued from page 6

maritime—will integrate 60 countries economically and technologically along the way. Beijing is actively seeking to re-focus its international relations on win-win economic relations rather than being mired in political confrontation and military competition. Overholt believed that this is the right vision for the future and deserves respect, and he urged the U.S. to join this effort.

## ASSESSING THE PROSPECTS FOR XI JINPING'S LEADERSHIP

**Dr. Paul Heer**

Robert E. Wilhelm Fellow, MIT, Center for International Studies; former National Intelligence Officer, East Asia

**September 16, 2015**

Whereas President Xi Jinping of China is widely perceived as a decisive and strong leader, well-connected politically through his princeling family background, Dr. Paul Heer, detected his weaknesses and vulnerabilities. In his talk, Heer delineated the challenges and dilemmas confronting Xi's leadership underneath Xi's confident and visionary public appearance.

On the surface, Xi takes the center stage of the Chinese political scene not only by being President of the PRC, Chairman of the Central Military Commission, and Secretary General of the Communist Party of China (CPC) but also by chairing several important committees himself, covering issues from national security and military reform

to internet security and economic reforms, which probably exceeds his expertise. The flip side of taking on so many responsibilities and having so much concentrated power is that he appears unwilling to delegate any decision-making and thus leaves no room for scapegoats in case of crisis in any one of these areas.

Xi is mired in many immediate tactical problems such as the stock market turmoil and the downward pressure on the Renminbi (RMB) in foreign exchange markets this year. These could divert his attention and energy away from China's long-term strategic needs, as reflected in the policy agenda of the 3rd Plenum of the 18th Party Congress. Heer observed that the policy agenda seems stalled after two years, as Xi straddles between those immediate challenges and long-term strategic issues at the same time.

The scale and the depth of Xi's anti-corruption campaign may be another reason for slowing the policy agenda. Heer believed that Xi's desire to clean up the party is genuine, but a competing motive for Xi is to remove political rivals and opponents of his policies. Taking Zhou Yongkang's case as an example, Heer initially thought Xi would be cautious about this high-profile case and not prosecute him in court, since Zhou is a former Politbureau Standing Committee member in charge of national security matters, the highest-level official to fall from grace for corruption charges. But Xi proceeded with prosecution anyway and Zhou was convicted. Heer speculated that the more personality-based and politically vindictive the campaign is, the more Xi risks alienating officials whose support he will need for his policy agenda.

Continued on page 8

Continued from page 7

Heer also perceived that resistance to Xi's policy agenda was inevitable, and that opposition to it need not be cohesive or have clear leadership. It is only a natural consequence that vested interests began to resist Xi's reform agenda, and even resent his initiatives. Furthermore, such opposition is not a concerted, identifiable group of

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**This passive resistance, compounded with the sheer difficulties of the policy agenda, is hindering the whole reform process. Thus it is no surprise that the 3rd Plenum agenda and anti-corruption campaign are losing steam. After all, Xi is not an omnipotent figure who can do anything and can do no wrong.**

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people which could then be eliminated, but a faceless foot-dragging attitude pervasive throughout the bureaucracies. This passive resistance, compounded with the sheer difficulties of the policy agenda, is hindering the whole reform process. Thus it is no surprise that the 3rd Plenum agenda and anti-corruption campaign are losing steam. After all, Xi is not an omnipotent figure who can do anything and can do no wrong.

Xi is often compared with his predecessor, Hu Jintao, whose reign is sometimes dubbed as "a lost decade." Heer thought that both Hu's weaknesses and Xi's strengths are overblown, even though Xi is clearly more than just "first among equals." Moreover, the policy agenda of

the 3rd Plenum is a product of consensus within the party about China's future directions. To Heer, Xi's policy agenda represents more continuity than change from the past, especially in foreign policy. In addition, Xi's widely publicized concept of "the China Dream" – to rejuvenate a nation which had a century of humiliation – is certainly not new, but only the latest version of a nationalist ambition.

Xi may aspire to be like those paramount Chinese leaders before him, Mao Zedong and Deng Xiaoping, but according to Heer, it is not yet clear whether Xi possesses their political skills and expertise to overcome bureaucratic resistance and achieve the kind of fundamental transformations that they achieved. Deng Xiaoping's pinnacle southern tour of China in 1992 really aimed at energizing the reform agenda rather than merely sidelining his opponents. Heer suspected that Xi's priority might not be the same as Deng's of 1992.

In conclusion, Heer warned not to overpersonalize the policy direction of China's top leaders, since both China's domestic circumstances and external environment are more fundamental drivers of Chinese behavior than generational change in the leadership. China now faces the challenges of an economic slowdown domestically, the U.S. rebalance to Asia, renewed tensions over the East and South China Seas, and an inexperienced leader in North Korea, among many foreign policy challenges. These domestic and external changes shape the prospects for the Chinese top leadership.

## CHINA, THE MIDDLE EAST, AND BEYOND

### Ambassador Chas W. Freeman, Jr.

Senior Fellow, Watson Institute for International Studies, Brown University; former Assistant Secretary of Defense for International Security Affairs; former U.S. Ambassador to Saudi Arabia; former Principal Deputy Assistant Secretary of State for African Affairs; former Deputy Chief of Mission and Chargé d'affaires in the American embassies in Bangkok and Beijing; and former Director for Chinese Affairs at the U.S. Department of State

**September 23, 2015**

With two-thirds of the world's energy reserves, the Middle East is the epicenter of the world's increasing religious strife. How did the Middle East become a zone of intolerance and violence today? What are China's intention and role in this messy situation? What is the likelihood of more active Chinese engagement in the region? What are the prospects for Sino-American cooperation or rivalry there? Ambassador Chas W. Freeman, Jr., addressed these questions in turn during his talk.

Since Napoleon landed in Alexandria in 1798 and launched the first foreign effort to impose Western-style government on an Arab people, the Middle East was basically a passive and impotent object of contention between imperial powers during the following two centuries. Western rampage through the Middle East subjugated its peoples, subverted their traditional values, imposed unwanted states and borders, extracted enormous

profit from their energy resources, and killed and displaced millions of native people. The Islamic Revolution of 1979 in Iran and the Arab uprisings of 2011 mark the end of this epoch of passivity and victimization. The Arab people began to believe that incumbent regimes lack legitimacy and remain in power only because of foreigners' protection, especially by their American patrons. This simultaneously anti-establishment and anti-Western sentiment is widespread in much of the Arab region and gives momentum for what Arabs view as justifiable counterattacks and counter-humiliations of the West. Thus, the recent overthrow of those autocracies in the states established by European conquerors has created a very chaotic situation. Conflicts and violence have replaced the unjust but tranquil order.

The collapse of the post-colonial order in the Middle East has coincided with China's return to wealth and power. But China's interests in the region seem to be very narrow, almost exclusively in the realm of commerce. In Freeman's view, it has suited both the Chinese temperament and China's national interests to stand on isolationist principles rather than develop a strategy apart from access to energy and the sale of goods and services. China has no protectorates or client states in the region and pursues no ideological agenda there.

China's relations with the Middle East are ancient but less obsessively linked to religion than those of the West. The Chinese "Silk Road" for more than a millennium linked China to Persia by land. Admiral Zheng He (郑和) of the Ming dynasty developed, in the 15th century China's maritime ties, to the Middle East, although China soon abandoned Zheng's outreach. Communication and

Continued on page 10

Continued from page 9

links are now restored with China's recent proposals for a new Silk Road, backed by a \$40 billion infrastructure investment fund. The Middle East is already important to China economically. It supplies half of China's oil imports, or about 30 percent of its domestic oil consumption. China is the largest foreign investor in Iraq's oil production. Qatar is China's biggest source of imported gas. Iran is a large potential source of gas and oil. China is the region's biggest trading partner after the European Union.

Despite this close economic relationship, there is something inherently alarming to the Chinese about a region where politics center on contests of religion or the degrees of religiosity. Chinese society has traditionally inclined toward religious skepticism, even though Islam had reached China by 651 A.D. So China remains cautious about the Middle East even as an energy source. It has not established a "strategic partnership" with any country in the region, as it has in other parts of the globe.

Another reason to explain China's aloof stance in the Middle East is its "five principles of peaceful coexistence," crafted for dealing with India in the 1950s. This doctrine stipulated that relations between states should be conducted on the basis of "mutual respect for each other's territorial integrity and sovereignty, mutual non-aggression, mutual non-interference in each other's internal affairs, equality and cooperation for mutual benefit, and peaceful co-existence." The five principles were an effective repudiation of China's traditional hegemonic tributary relations with foreigners, and an affirmation of the Westphalian order that is the foundation of the United Nations Charter. With these principles, China has become one of the world's most committed advocates of the sovereign equality of states,

their immunity from foreign dictation or intervention in their domestic affairs, and their right to their own ideology regardless of foreigners' views. Although China is often criticized by Western bureaucrats and politicians for its insistence on separation of business from politics, those doing business with China find its apolitical approach to trade and investment reassuring and refreshing.

While China's neutrality in the region endears it to no one, it has enabled China to avoid involvement in the region's toxic politics, dangerous wars, and challenges to established powers like the United States. Beijing has carefully dissociated itself from the U.S.'s misadventures in Iraq, Libya, and Syria but has not exercised its veto to block Washington in the UN Security Council.

Despite China's aloof stance on the Middle East, it is conceivable that China could be drawn into the regional politics for two reasons. First, religious affinities connect Chinese Muslims to the region, making China susceptible to all the strife in the Arab world. The Uyghurs now fighting with Daesh (Islamic State) in Iraq and Syria have linked their anti-Chinese insurgency in Xinjiang directly to the revolutionary theocracies of the Middle East. Daesh's acquisition of a Uyghur component has led it to endorse armed jihad in China. Thus China has pledged to aid the Iraqi government's fight against Daesh "from the air." This is a small but significant step for China toward military involvement. Second, there are thousands of Chinese oil and construction company employees in Iraq, which could attract the malevolent interest of Daesh. There is mounting pressure from these enterprises and individuals for China to take a more active role to secure their safety.

Continued on page 11

Continued from page 10

Still, Freeman believed that China's narrow commercial interests would limit its potential for more and deeper involvement in the Middle East. He predicted, in conclusion, that China would remain the champion and vindicator only of its own interests, currently limited to access to energy and markets and the safety of Chinese citizens who labor or do business there. China would retain its political neutrality, avoiding any contagion from the region's wars and any challenges to established powers. Beijing would be neither a potential rival nor a partner to Washington in the region.

## XI JINPING'S VISIT TO THE UNITED STATES

**Professor Ezra Vogel**

Henry Ford II Professor of the Social Sciences  
Emeritus, Harvard University

**September 30, 2015**

How to evaluate President Xi Jinping's visit to the U.S. from September 22-25, 2015? Is it as significant and fruitful as portrayed by the Chinese media? Or as negative as portrayed in some of the Western media for lacking substantive progress in resolving difficult policy issues? Or as insignificant as it appeared in contrast to the visit by the Pope, showered with attention from the American media and with affection by the American public?

Ezra Vogel viewed Xi's visit in a broader historical and political context and concluded that this was a constructive visit from the point of view of keeping a

broad and deep engagement with China and making modest progress in moving Sino-U.S. relations forward. By participating in the luncheon at the U.S. State Department on September 24, Vogel was able to provide a first-hand account of the political atmosphere in Washington and of Xi in action.

He first pointed out a general misperception about any state visit. Most people focus their attention on the two heads of state, the nature of the relationship and what they say during their meeting, while neglecting the huge scale of preparations by many people before the meeting, including the increased attention to the bilateral relations, as well as the numerous meetings between specialists alongside the state visit, covering a variety of issues and trying to move them along. True, the extensive American media coverage of the Pope's activities distracted the U.S. media and the public, but this also reduced the attention to U.S.-Chinese problems before and during the visit. Demonstrations by Falun Gong and Tibetan groups were relatively subdued compared with President Jiang Zemin's visit in 1997.

Xi's private dinner with President Obama on Thursday night, the night before the busy day of ceremonies, a luncheon, and a banquet, had been scheduled for two hours but actually went for three hours. This was interpreted as a good sign of frank conversations between the two leaders on important issues facing the two countries. The next day, Xi received a 21-gun salute at the White House, as well as the Biden-Kerry luncheon and a state dinner with President Obama. Xi's visit as a whole

Continued on page 12

Continued from page 11

was very well prepared and orchestrated by both sides and went smoothly.

While guests waited to eat at the luncheon at the State Department, Secretary John Kerry gave a thoughtful broad-ranging prepared speech about the importance of the relationship. Vice President Joe Biden, compared with President Obama, who had the responsibility for dealing with Xi on tough sensitive issues, could draw on the Xi-Biden meetings while both were vice presidents, and give a warmer and more relaxed account of U.S.-China relations. Xi was relaxed and poised as he read his prepared text designed to promote a strong U.S.-China relationship. Midway through the meal, many guests rose and walked to other tables, greeting friends and networking.

Compared with previous Chinese leaders' state visits to the U.S., Vogel felt that Xi's visit took place in a most difficult and tense period due to the increasing tension over the South China Sea disputes, expansion of the Chinese military and cyber espionage. Vice Premier Deng Xiaoping's visit to the U.S. in 1979, celebrating the normalization of relations and the launching of the reform and opening policy, was more fun and less problematic. Deng was more experienced and comfortable with foreign affairs than Xi is, although Xi is poised and a fast learner. President Jiang Zemin's visit in 1997 was the first top Chinese leader visit after the Tiananmen Tragedy of 1989, when Chinese human rights issues hung over the relationship. But Jiang, unlike Xi, had some western education before 1949. He had an outgoing and buoyant temperament, and occasionally quoted English classics such as Lincoln's Gettysburg address. President Hu Jintao visited the U.S., meeting President Bush in a non-state visit in 2008 and President Obama in

a state visit in 2011. China was feeling stronger after the Western financial crisis, and its own growth and military modernization had increased its confidence. The "rise of China" had strengthened apprehensions in the United States. Hu Jintao was more business-like than Jiang and had a low-key approach more characteristic of bureaucrats than confident political leaders.

Tensions over China's military assertiveness in the South China Seas, reported cyber threats, treatment of foreign businesses and Western reporters have continued to rise since Hu Jintao's 2011 visit. China's tightening of space for free speech and teaching western ideas in China has increased the concern of Western academic China specialists who had been strong supporters of closer U.S.-China relations. China's official list of seven subjects not to be talked about in the public discourse (七不讲: universal values, freedom of press, civil society, human rights, the Communist Party's past mistakes, elite cronyism and judicial independence) has created an environment where many Chinese feel cautious about communicating with foreigners. With heavy management and a strict filter of the Chinese media, Vogel worried if the Chinese public could hear pluralistic voices and perspectives, if American businessmen in China could get free flow of information, and if American students would feel welcome in China.

Vogel recognized the contribution of China's success in nourishing a small elite group in government dealing with foreign affairs, who have received a western education and are well-connected with and extremely knowledgeable about the U.S., such as Yang Jiechi, Zhang Yesui, Cui Tiankai, Wang Yi, and Zheng Zeguang. Although

Continued on page 13

Continued from page 12

they may not be powerful in making the final political decisions, their expertise informs Chinese political leaders and enables them to interact well with a broad range of Western elites. He lamented that none of the Chinese or American leaders had a deep knowledge about and experience in dealing with the other country and an opportunity for in-depth informal discussions with the other side. Of the Politburo members, only Wang Huning had an extensive knowledge of the West, but he has now cut off his informal contacts with Westerners and Western specialists in China. None of the high American officials had a deep knowledge of China. Other important political officials who accompanied Xi include Li Zhanshu, a former colleague of Xi's in Hebei and now head of the Central Party Office, and Wang Qishan, in charge of economic and anti-corruption issues.

On substantive issues, the two sides agreed to establish a hotline to resolve and prosecute cyber theft. China acknowledged that it was improper to use cyber theft to gain economic advantages. China agreed to avoid militarization of the disputed islands in the South China Sea. China took steps to support contributions for managing global environmental issues. The U.S. indicated to China that it was uncomfortable with the Chinese use of the term, "a new type of major power relations" because this concept aroused concern in Southeast Asia where the Chinese were using the phrase to help convince the Southeast Asians that the U.S. was more responsive to China than to their concerns. It also aroused concern in Japan which felt excluded from important discussions. The Chinese nonetheless continued to use the term in reports of the Xi visit.

There were no significant breakthroughs in any of the policy areas, but there was modest progress in many of them. The Chinese distributed an account of over 40 areas where agreements were advanced as a result of the visit. The visit deepened contacts between a broad range of officials on the two sides in a business-like atmosphere and allowed them to deal with a variety of specific issues. The Chinese press is filled with accounts of a successful visit by their president, and if anything, the Western media's criticism of China was slightly subdued compared to the weeks before the visit. U.S.-China tensions have not begun to disappear, but the Xi visit to the United States has advanced the effort for the two countries to find ways to manage their differences.

## CHINA IN THE WORLD ECONOMY: THE NEW NORMAL

**Edwin Lim**

China Economic Research and Advisory Programme; former CEO of the China International Capital Corporation (CICC); former economist for The World Bank; former director of The World Bank's China office

**October 14, 2015**

Whereas Mohamed El-Erian, former President and CEO of Harvard Management Company, coined the phrase "the new normal" for a profoundly different situation after the 2008 financial crisis, the Chinese government

Continued on page 14

Continued from page 13

uses this phrase to describe China's transition from a high growth rate of almost 10 percent per year for about three decades to a medium growth rate of about seven percent. In his talk, Edwin Lim concurred that this is an appropriate phrase to describe China's economy today. He explained the rationale behind this transition, the key elements of the new normal, and the process to achieve it.

China's near double-digit growth rate since the early 1980s was mainly driven by resource-heavy investment and exports of manufactured goods at low costs. This conventional model became unsustainable as high levels of investment became increasingly inefficient and environmental degradation became unbearable. In addition, income was so unevenly distributed that by the measure of the GINI index, China was ranked near the bottom along with many Latin American countries. Worse than inequality is the unfairness, widely perceived by the Chinese public, of corruption in land acquisition without adequate compensation. At the same time, China's private consumption was very low, about 35 percent of GDP, half of the size of the U.S., while savings were unusually high, over 50 percent of GDP, largely used to finance large-scale investment, including export processes. As China became the world's largest factory of manufactured goods, it also became the largest emitter of greenhouse gases, while its excessive exports at low prices caused resentment abroad.

Recognizing the unsustainability of this pattern, the Chinese government began to call for a new growth model around the turn of the 21st century. Since then, China has embarked on a transition, although not complete yet, to a more service-oriented, more consumption-driven economy, and an adjustment to a "new normal." The

most salient feature of this new normal is a much slower economic growth rate. Allowing slower growth signifies China's official acknowledgement that quality of growth is more important than quantity of growth, which is a good thing in Lim's view. He estimated that the new growth rate would be closer to five percent than to 10 percent; but given the size of the Chinese economy today, even a five percent growth now would produce more GDP increase in quantity than a 10 percent growth two decades ago. The Chinese government used to worry about potential massive unemployment if the growth rate fell below eight percent, but this should no longer be a problem because of a declining working-age population, near exhaustion of migrant workers, and the vigorous growth of the service sector to absorb labor. The rising general wage level in China is a sign of this underlying structural change.

Looking to the future, Lim anticipated negative market pressure on the RMB exchange rate due to China's shrinking current account surplus and increasing outflow of capital. As a consequence, China's foreign exchange reserves are likely to fall in the coming years. The days when Chinese savings financed American consumption are over. More U.S. government securities will come to the market as China's foreign exchange reserves shrink. Lim also anticipated that China would play a leading role in environmental protection in general and climate change mitigation in particular, which would benefit both ordinary Chinese and the rest of the world. He warned that resource exporters such as Brazil and Australia should not expect China's demand for raw materials to rebound any time soon since China is transitioning away from the resource-

Continued on page 15



Continued from page 14

heavy growth model and becoming an upper-middle income country.

On the question of how to sustain this new normal, Lim highlighted three elements now underway. First, the government has decided to let market forces play a decisive role in allocating resources. This is easier said than done since it's always difficult for any government to decide when to intervene in the market. The Chinese government intervened in the stock market after it plunged sharply this summer, but it didn't work as well as the government hoped. The Chinese central bank (People's Bank of China) also allowed the RMB to depreciate about three percent this August. Although it caused much fear about potential competitive depreciation in the region, it was a move responding to market pressure.

Second, the government has explicitly called for a governance reform, including transparency and efficiency of the government budget and the re-alignment of center-local government relations. The words, "market" and "governance," were so frequently used in "decisions" of the 3rd Plenum of the recent Party Congress—the Chinese Communist Party's official blueprint for reform—that would have been unimaginable three or four decades ago.

Third, China is pushing to reform state-owned enterprises (SOEs), a main source of inefficiency and perceived unfairness. Lim warned that simple privatization of SOEs might increase the operating efficiency of the enterprises but could be at the cost of damaging the balance sheet of the state sector. This is the lesson we can draw from the experience of the British government under Prime Minister Thatcher in selling state assets and using the proceeds to finance public consumption. The long term

objective of SOE reform in China today is to change the role of the government from an active manager of the enterprises to that of a financial investor. China intends to retain a large volume of state capital in the economy but is seeking to create a more efficient form of state capitalism. It has, however, not yet been able to define exactly how it will be able to achieve this. The SOE reform remains a major challenge for China in its effort to achieve a more efficient and equitable model of development.

## URBANIZATION AND THE FUTURE CHINA

**Professor Meg E. Rithmire**

Assistant Professor, Business, Government,  
and the International Economy Unit,  
Harvard Business School

**October 28, 2015**

As countless high-rise buildings are erected in clusters in remote Chinese cities and suburbs during state-led urbanization over the last decade or so, their prospects are increasingly in doubt: will these clusters of high-rises become new centers of future bustling cities, or end up as lifeless museums merely demonstrating the consequences of bad decisions of the past? Meg E. Rithmire contended that, with the right policies, such as a universal social welfare system uniformly applicable to all Chinese citizens, many of such clusters could become new vibrant cities, and avoid the fate of Ordos in Inner Mongolia, where many high-rises are

Continued on page 16

Continued from page 15

vacant, libraries have no books and theaters have no plays. Rithmire also gave a lucid account about the many hurdles and risks along the way, illustrating why urbanization in China will not be a smooth ride.

By the World Bank's classification, China is already an upper-middle income country. In the category of upper-middle income countries, China has the highest rate of industrialization but the lowest rate of urbanization despite the government's push in recent years. How could this be the case? Rithmire attributed this paradox to some institutional barriers that prevent free movement of people and free turnover of land ownership. The Chinese *hukou* registration system basically locks people in where they were born, preventing rural people's relocation to urban areas.

The Chinese social welfare system—unemployment insurance, healthcare insurance, retirement benefits, even the right to education in public schools—is allocated based on one's *hukou*, which identifies where he or she is from and belongs. Even if rural people leave their farmland behind and move into one of the high-rises, they still don't have the same social welfare benefits that urban people enjoy. So losing their farmland means not only losing their livelihood, but also their social safety net. These rural people without land or necessary skills to be employed in cities could constitute a new social problem of concentrated poverty in urban areas.

Another institutional barrier to a higher level of urbanization has to do with public land ownership in China. In the urban area, land is owned by the state; while in the rural area, land is owned by the collective. Transfer of rural land into urban land is possible when a local government in the urban area acquires it for industrial, commercial or

residential development. After the tax reform of 1994, local governments took on more responsibilities but with a reduced share of tax revenue (an increased share went to the central government). They had to increasingly rely on "extra budgetary revenues," most of which came from land leasing, i.e., the so-called "land financing." This motivation, along with the constraint of the *hukou* system, resulted in an over-urbanization of land (or over-built) and under-urbanization of people, hence many "ghost towns" with largely vacant high-rises.

China's land policy has also resulted in other problems. First is the rapid and sharp decline of farmland during the decade of 1995-2005, which raised the question of potential food shortage for 1.3 billion Chinese people. This necessitated another policy of protecting farmland area of at least 1.8 billion mu (120 million hectares), a red line not to be broken. Second is hollowing out rural villages as urban cities sprawl outward. Many villages only have young children and old people left behind. Third is the increasing tension between the state and society during the rapid urban expansion due to inappropriate land expropriation and inadequate compensation. Stories about the experiences of holdout residents (钉子户) are ample in the Chinese media.

To alleviate these social problems and economic distortions, there has been a new plan over the last two years for a new style urbanization. According to Rithmire, the Chinese government still intends to push forward urbanization but in a different way. It now aims to rebalance the Chinese macro-economy by encouraging consumption and low-carbon, environmentally-friendly

Continued on page 17

Continued from page 16

investment, and moving away from resource-intensive investment. It intends to manage the pace and direction of urbanization, avoiding building and expanding megacities, encouraging development of smaller towns and cities, while embedding this development in the development plan of a much larger region. The government is also attempting to develop possibilities for agricultural agglomeration and large-scale agri-business. Since the current average size of Chinese farmland is very small, there is much room to improve efficiency by enlarging the economies of scale.

Rithmire did not view China's state-led urbanization as another Great Leap Forward or Stalinist forced urbanization, nor a process of complete free mobilization of labor, land and capital—all ingredients of economic production—or an intermediate step to an inclusive democracy, as in Britain where all people's voices after massive urbanization mattered. Rithmire acknowledged some progress in China's financial liberalization efforts, local government debt reforms, and central government's fiscal reforms, but pointed out that the core of public land ownership and the *hukou* system remain unchanged, despite some reforms around the edges of these entrenched institutional barriers. These barriers will eventually limit the extent of the success of the new style urbanization.

## URBANIZATION WITH CHINESE CHARACTERISTICS: CHINA'S NATIONAL PATTERNS IN INTERNATIONAL PERSPECTIVE

**Nicholas Eberstadt**

Henry Wendt Scholar in Political Economy,  
American Enterprise Institute

**November 4, 2015**

Since 1970, mass migration in China—about one-third inter-provincial and two-thirds intra-provincial—resulted in a sharp increase in the percentage of a floating population in urban areas from three percent in 1990 to about 20 percent in 2010. Despite this surge, however, China is still considered under-urbanized today for a country of its income level.

Nicholas Eberstadt examined copious data across time and countries and concluded that China was over-urbanized in the 1970s under Chairman Mao's leadership. But it has been under-urbanized since the mid-1980s, demonstrating that at its current income level, measured by GDP per capita, China is under-urbanized compared with Japan, South Korea and Taiwan, all of which are far more urbanized at similar income levels.

Eberstadt explained the economic costs of China's under-urbanization. Through regression analysis, he noted that China would have been about 10 percent more productive if it was at the corresponding degree of urbanization based on the experience of other countries. GDP per capita is highly correlated with the level of human

Continued on page 18

Continued from page 17

resources, measured by education level (mean years of schooling); health level (life expectancy); business climate, referring to the quality of local institutions and policies, as well as the degree of urbanization.

Analysis shows that for one percent higher urbanization, GDP per capita is two percent higher. Depending on which exchange rate to use (market rate or purchasing power parity [PPP]), China is about 70 million to 100 million migrants too few for its levels of income, education and health, which translates into a loss of potential productivity of 10-15 percent. Eberstadt suspected that institutional barriers such as the Chinese *hukou* registration system and insecure land property rights contributed to this under-urbanization, but is unable to prove definitively and exclusively that these were the causes of under-urbanization in China.

He pointed out the fact that the population densities of large cities in Japan and South Korea are much higher than those of many Chinese cities, but still with well-maintained environmental standards, which indicates that there is still room for Chinese cities to expand and absorb more migrants. For example, Seoul doubled its population over the last 40 years while becoming an environmentally cleaner city.

By extensively studying the demographic structure and education profiles of the urban, rural and migrant populations in China, Eberstadt demonstrated an urgent need of the urban areas for continuing migration from the rural areas, or they will face the consequences of aging population and working-age population decline, where the working-age population is defined as people 15 to

64 years old. Eberstadt acknowledged that this definition is not reasonable since these days more people enter the labor force much later and live a healthy life much longer, but this definition of working age has been conventionally used for national censuses, on which this study is based.

However, this study revealed that most well-educated rural people in China have already migrated into cities and few college-educated people are left in the countryside, implying a limit on the supply of more educated people to the urban areas. Whereas Guangdong, Zhejiang, Shanghai, Beijing and Jiangsu along China's coast have attracted large numbers of migrants, inland areas such as Jiangxi, Hubei, Sichuan and Henan are the main

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## China's "economic miracle" has benefited tremendously from the mass migration of people from rural to urban areas.

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providers of migrants, whose *hukou* registrations indicate that they originate from these poorer provinces.

China's "economic miracle" has benefited tremendously from the mass migration of people from rural to urban areas. Yet even with increased migration, China's pace of economic development has been hindered, likely by the *hukou* system. Eberstadt's study showed how this has played out in China's economic development and indicated that any future waves of urbanization will likely have less auspicious impacts on China's growth due to its demographic outlook.

# CHINA'S ECONOMIC REBALANCING CHALLENGES

## Guonan Ma

Senior Fellow, Fung Global Institute; non-resident Fellow of Bruegel, the Belgian think tank; former Senior Economist at the Bank for International Settlements

**November 18, 2015**

It is conventional wisdom that the Chinese economy has undergone an investment-led, consumption-depressed growth and needs to be rebalanced. Is this an accurate diagnosis of the Chinese economy? How exactly did this economic imbalance happen? What are the drivers of this imbalance? What are the triggers for rebalancing the Chinese economy? What are China's growth potential and prospects? And what are China's challenges in rebalancing its economy? In his presentation, Guonan Ma addressed these questions with refreshing insights and offered a more nuanced reading of the Chinese economy than the crude conventional wisdom.

First, Ma asserted that how we frame China's imbalance—in terms of shares versus growth rates of the three components of the GDP; and historical trends of these components versus a horizontal comparison of them with other countries'—would affect our conclusions. He contended that we should view China's imbalance in a more balanced manner by taking into account all of these angles. At the outset, he pointed out that external imbalance is no longer China's major problem as its current account surplus has shrunk from over 10 percent of GDP in

2007 to below three percent now; instead China's internal imbalance between consumption and investment has taken the center stage.

A closer and more comprehensive examination of the data reveals that, although the investment share of China's GDP is still much bigger than the private consumption share, the average annual growth rate of Chinese private consumption appears robust in recent years and even has outpaced that of China's overall economy since 2010, which in turn outpaced that of Chinese investment. Both globally and historically, China has been among the strongest consumer economies in the post-war area. Thus to Ma, characterizing China's economic growth as investment-led and consumption-depressed is misleading. One strong implication is that any meaningful Chinese domestic rebalancing will first and foremost be featured with a deceleration of investment and not with a further acceleration of consumption.

In China's investment surge prior to 2010, Chinese households, as opposed to Chinese corporations and the Chinese government, took the leading role in providing higher savings and contributing to more than 50 percent of the investment increase, while losing out in the income distribution themselves. Conventional wisdom believes that a decrease of households' income as a percentage of GDP has been the principal factor behind anemic consumption and a decrease in consumption as a share of GDP. But Ma has a contrarian view that the lower Chinese marginal propensity to consume rather than the lower household income share has been the dominant reason behind a lower consumption share in the economy. And a

Continued on page 20

Continued from page 19

key reason for the lower Chinese consumption propensity has been the much higher household savings related to the rising capital formation undertaken by households themselves. Such fast household investment may in turn be associated with rising self-employment and growing housing-related investment spending.

More generally, why is the consumption share in GDP so low, below 40 percent, and that of investment in GDP so high? The mainstream view attributes this domestic imbalance entirely to distortions due to China's cheap factor prices—prices of labor, capital, land and energy do not reflect their real value. But Ma felt that multiple positive income shocks had been overlooked in interpreting the causes of this imbalance. These positive shocks include productivity increase and efficiency gains from institutional and market reforms, from large-scale resource reallocation from rural and state sectors to urban and private sectors, from transfer of technology and know-how from abroad into China, as well as from a more secured access to foreign markets by joining the WTO and integrating into the world economy. Big housing demand shocks from the constitutional amendment and introduction of mortgages also boosted investment. These positive shocks have resulted in large income windfalls, much of which have been saved, thereby available for more investment, while simultaneously boosting Chinese consumption.

Looking to the future, Ma believed that such positive income shocks will diminish because of the ageing population, a Lewis turning point, higher labor cost, fewer low-hanging fruits from liberalization and a less accommodating global economy. (Named after economist W. Artur Lewis, a Lewis turning point is a term used in

economic development to describe a point at which surplus rural labor reaches a financial zero). Also, natural economic forces, such as rising capital-output ratio, diminishing return to capital and rising corporate finance costs, will reverse the imbalance to some extent, but at the same time will also lower China's potential growth rate significantly. Finally, some distortions may also start lessening: the land is no longer cheap, and the cost of damaging environment no longer negligible. This trend already started a few years ago. That is one reason why China has been facing disinflation pressure for some time.

Ma forecasted China's average annual growth rate to be five percent for the next 15 years, and envisioned likely prospects of the Chinese economy if China rotates five percent, 15 percent and 25 percent of GDP respectively from investment to consumption. From these projections, he concluded that a slow pace of rebalancing would not be able to deliver long-term sustainability by 2030; and that fast economic growth along with aggressive rebalancing is highly unlikely. He identified the challenges ahead to be whether China's private consumption is resilient enough to hold up in a much slower economic growth environment and whether the diminishing return to capital can stabilize.

# CHINA AND ASEAN: THE CRITICAL ISSUES

**Professor Arne Westad**

S.T. Lee Professor of U.S.-Asia Relations,  
Harvard Kennedy School

**December 2, 2015**

When the Association of Southeast Asian Nations (ASEAN) was established in Bangkok, Thailand in 1967, it was seen as an international organization with local anti-imperialism and anti-China roots. How has the relationship between China and ASEAN evolved over time? How is it impacted by the recent tensions over the South China Sea disputes? What is the potential of this relationship? And what are the critical issues it has to confront in the future? Arne Westad addressed these questions in his talk.

The relations between China and ASEAN are the most important relations in Asia, according to Westad, not only because of this region's economic dynamism but also because of the complementarity between their economic structures, which makes them a natural pair. But their perceptions of each other and their respective history often separates them and makes them suspicious of each other. Westad predicted that their respective concerns for sovereignty and security will stay with us for a long time.

Southeast Asian countries have had a long and troubled history with imperialism and colonialism, in which they were caught between two forces of empires—European and Chinese. Westad pointed out that this history is often overlooked, therefore these countries' strong nationalism and serious concern for sovereignty are not

fully appreciated. He explained that these countries had tense relations with China from the early 20th century to about the 1970s until the Chinese paramount leader Deng Xiaoping turned them around in the early 1980s. Warming up relations between China and ASEAN in the 1980s and 1990s was crucial for ASEAN to partially re-invent itself into an organization for economic integration.

But this benign picture changed around 2008 as tensions over the South China Sea became prominent, threatening to undo Deng's achievement in these important relations. Westad warned that if nothing changes, enmity between them could go back to the pre-1980s level. He considered how China dealt with ASEAN on security relations as an indicator of where China would go and how it would behave internationally after it masters sufficient prowess on the world stage. On the positive side, Westad viewed ASEAN as a multilateral framework that offers China a potential opportunity to be integrated into Southeast Asia over the long run. He acknowledged ASEAN's own challenges, including the lack of a natural leader and of path-breaking initiatives.

He speculated about the future of these relations. There is a question of what the Chinese leadership really intends to do with ASEAN ultimately. If it tries to break up ASEAN, then a consequence might be to make ASEAN countries unite together more easily with China as their common enemy. If not, then these Southeast Asian countries are more likely to focus on their economic integration and development.

Would economic integration with China divert ASEAN countries' concerns for sovereignty and security?

Continued on page 22

Continued from page 21

No, according to Westad, but it makes the situation better than without economic integration. It is conceivable for ASEAN to build equitable, fair, and mutually beneficial economic relations with China through arrangements such as the currency swap initiative after the Asian financial crisis in 1997-98 and a free trade area, if it is not held back by some individual countries.

Economic complementarity and cooperation opens up enormous potential and opportunities, but also creates difficulties at the same time. Poorer countries like Myanmar and Vietnam may become more reliant on China as a result of further economic integration. There is also a risk of superimposing trade and capital integration into treaties before private enterprises are ready on the ground. Different perceptions of one another for historical reasons have to be managed carefully.

Over the past seven years or so, with enhanced maritime military capabilities, China has become more assertive of its own sovereign rights. On the surface, China, along with other countries, acknowledges the UN Convention on the Law of the Sea and freedom of navigation, but in reality, an effective code of conduct is needed to minimize the possibility of collisions during fishery, mining and other maritime activities.

Westad believed that it is strongly in ASEAN's interest to move to territorial solutions sooner rather than later because time is against them—China is on the trajectory of becoming more powerful, and more difficulties would arise as the world becomes a multi-polar world. He conjectured that the eventual outcome over the South China Sea is likely to be maintaining the status quo—what you will have is what you already have now. The question then is how to get there,

either through warfare by which China could either directly or indirectly control most of the region, or through peaceful means. Since the route to get there also depends on what happens outside of the region, Westad encouraged the U.S. and Japan to facilitate a peaceful resolution.

Westad preferred to think positively—that ASEAN offers a real possibility of socializing China into a community of states. He did not expect China to formally join ASEAN or AAN (Association of Asian Nations) but believed that building a web of treaties of trade and investment mobility between them will enhance their integration, which is better than the alternative of fostering animosity. He did not hold high hope for the current regime in Beijing to move in this direction, but emphasized that it is in China's own interest to have better relations with ASEAN.

## BOOK TALK: WILL AFRICA FEED CHINA?

**Professor Deborah Brautigam**

Author; Bernard L. Schwartz Professor in International Political Economy; Professor of International Development and Comparative Politics; Director of International Development Program and China-Africa Research Initiative, School of Advanced International Studies (SAIS), Johns Hopkins University

**December 9, 2015**

It is conventional wisdom in the public perception in the West that China has acquired a large amount of land

Continued on page 23



Continued from page 22

in Africa for the purpose of growing food and then sending it back to China, that China either has sent, or plans to send, millions of Chinese farmers to work in Africa, and that this land grabbing is a Chinese government initiative backed with state funding. Is this a truthful description of what has happened on the ground or merely myths perpetuated by the media and others?

Deborah Brautigam busted this conventional wisdom with copious evidence from her long-term research on China in Africa and a recently published book entitled *Will China Feed Africa?* At the outset of her talk, she quoted from a former Washington Post correspondent in Beijing, “Inflating the challenge from China could be just as dangerous as underestimating it.” With this warning in mind, she began her counter-argument.

In a book published in 1995, entitled *Who Will Feed China?*, the author Lester R. Brown warned that an unprecedented rise in world food prices would be triggered by China’s rise to a middle-income country and its need to import an enormous amount of grain to feed itself. This book brought China’s food consumption to the public attention and foreshadowed China’s establishing a red line for protecting domestic farmland in order to secure food production. The rise of world food prices around 2008 renewed the world’s concern for food supplies. And every year, the first policy coming out of China’s State Council meeting has always been about agricultural issues.

Thus it is logical for China to go outside to secure food supplies. And Africa, with its expansive land and deficient infrastructure, offers huge potential for Chinese investment. But what and how has China been doing in Africa? Through extensive internet research and field

work with numerous interviews to follow up on about 60 alleged Chinese projects in Africa, Brautigam was able to debunk all the grandeur of these projects as reported in the media. The result of her probe is that many of these projects shrank dramatically in size and value; others disappeared altogether. Sometimes this was due to careless reporting, other times to formidable obstacles in the natural environment of the project location or in the social and political environment. The Ebola outbreak further put several projects on hold.

What are the Chinese actually doing in rural Africa? China has had a foreign aid program for Africa since the early 1960s, and helped some African countries build state-owned farms. When these countries came under the IMF pressure to raise money, they put up these state farms for sale. Some Chinese companies came to buy them in the 1990s. With the official foreign aid program, China has built 24 agricultural technology demonstration centers in 24 African countries.

While demonstrating Chinese technologies to Africans, these centers also help sell Chinese agricultural machinery and technologies to them. Chinese companies producing these machinery and technologies return to these centers to help maintain them while scouting for business opportunities. This is similar to the kind of public-private partnerships that USAID and other G8 countries’ aid programs have with respect to their own agribusiness companies.

Chinese entrepreneurs are the same as entrepreneurs of other countries. They look around the globe for business opportunities. Some of them find

Continued on page 24

Continued from page 23

profit potential in African agricultural business, and train local people for production, instead of bringing Chinese farmers from China on a massive scale, while they take care of marketing and distribution of these agricultural produce themselves—the higher value-added portion of the production chain.

Some Chinese private companies came to Africa around 2008 with a profit motive because world food and fuel prices shot up; however, now food prices are low. Brautigam suspected that these Chinese companies must be losing money by now, or at least are under market pressure. Other Chinese companies had no intention of acquiring land to produce food but wanted to invest in biofuel plantations. Africa does have extensive trade with China. Its top five agricultural export products to China are sesame seeds, cotton, tobacco, rubber and cocoa: no grains. But these are not enough to feed China with 1.3 billion people.

If Africa is not feeding China, who is? Brautigam explained that China tries to feed itself, with rice and wheat as protected areas, just like Japan. China's self-reliance on primary produce is supplemented by significant imports of other agricultural products like soybeans and maize, from the U.S., Brazil, Australia, Canada and other countries, mainly for animal feed.

Brautigam noted that Chinese official financial backing from the Ministry of Commerce and the Ministry of Agriculture through the Chinese Export-Import Bank that is going to Africa is not about securing land to grow food, but for supporting Chinese companies to go global in general. This money cannot be used to buy land in Africa.

In the mid-1960s, some Africans, epitomized by the then-president of Congo-Brazzaville, feared colonization by the Chinese communists. But this is not what's happening on the ground, concluded Brautigam. What the Chinese government and companies are doing in Africa is no different from the West. "The Chinese are following in our footsteps and playing our game."

## SINO-RUSSIAN RAPPROCHEMENT

**Alexander Lukin**

Department Head, Faculty of World Economy and International Affairs, School of International Affairs, National Research University Higher School of Economics, Moscow

**February 5, 2016**

After the Ukraine crisis in 2013-14, Russia talked much more about Asia Pacific as part of its "pivot to Asia." But its Asia focus actually has a long antecedent prior to the Ukraine crisis. Alexander Lukin explained this long history at his talk and analyzed the geopolitical as well as economic factors that have driven Russia and China closer together, addressing the question of whether China can supplement, even substitute for, Europe or the West at large in relation to Russia.

China has been Russia's largest trading partner since 2010, not counting all of the European Union (EU) member countries. It is true that Russia's total trade with China has somewhat decreased in recent years. Pro-western

Continued on page 25

Continued from page 24

media have exaggerated this decline, highlighting the difficulties and dangers associated with cooperation with China. Lukin countered that this bilateral trade decrease should be viewed from a larger perspective in which Russia's trade with Asia as a whole, as well as with many European countries, has all shrunk. This more holistic view points to the weakness in Russia's economy rather than difficulty in Sino-Russian relations.

After Russia's relations with the West turned sour, it looked to the East with high expectations. But these expectations are not yet fulfilled, according to Lukin. Critics of "pivot to Asia" claim that the Eastern countries—even though China is technically to the south of Russia—are too unpredictable and difficult to cooperate with. Some top Russian leaders are disappointed with China as well. President Vladimir Putin decided not to participate in the recent APEC meeting in Pasay, the Philippines, in November 2015.

Lukin's view of China and the Chinese is nuanced and realistic. China will not help Russia at its own economic sacrifice. The Chinese secured better terms for themselves by being tough negotiators. But they take the Russians seriously enough to be willing to compromise on issues of mutual interest. The Chinese are interested in Russia's market for their manufactured goods in exchange for Russia's energy and raw materials. They already signed several deals with Russia in the areas of oil and gas. More importantly, they share a common quest for a multi-polar world. In contrast to the West, the Chinese are not proselytizing their ideology—they don't try to Confucianize Russia or tell the Russians what to do.

In fact, Russia's pivot to Asia did not start with the Ukraine crisis. It has a long history, driven by both economic and geopolitical forces. Sino-Soviet "brotherly" relations went back to the 1950s. In 1986, President Mikhail Gorbachev initiated a new policy with more emphasis on Asia. In the 1990s, the Russian government was almost one-sided pro-West, but Moscow found itself playing a subordinate role to its western neighbors. In the late 1990s, Russia attempted to seek equal terms with world powers and began talking more about cooperation with China and India. This outreach fits into Russians' view of a multi-polar world. President Putin considered Asia a rising economic center, an alternative to the West, and promoted activities with Asia long before the Ukraine crisis. These efforts already have had a positive impact on the development of Russia's far eastern Siberia.

It is on this basis, in Lukin's view, that Russia and China have continued developing their relationship toward mutual trust and a comprehensive partnership. The Ukraine crisis did not inaugurate Sino-Russian rapprochement, but has affected the psychology of this bilateral relationship. Having lost trust in the West as a partner, Russian business people don't expect a turnaround anytime soon. They consider political risks of doing business with the West too high. Russia is no longer pro-West, even though it is still Western-centric in its traditional thinking and outlook. It also still has a shortage of specialists on Asia.

President Xi Jinping visited Moscow in May 2015 and signed a framework declaration, pledging bilateral cooperation on two potentially competing projects involving Russia and parts of the former Soviet Union:

Continued on page 26

Continued from page 25

the Russia-initiated Eurasian Economic Union (EEU) and the China-initiated New Silk Road initiative “One Belt, One Road” strategy to more tightly connect Asian, European, and African continents through transport and infrastructure development in Eurasia. President Putin then visited Beijing in September 2015, giving additional impetus to this multifaceted partnership with a strong geopolitical underpinning.

Lukin expected Russia to develop more ties with other emerging powers and peripheral countries, and more cooperation with and through the Shanghai Cooperation Organization and ASEAN. In his view, Russia’s pivot to Asia is already a reality motivated by both economic and political interests; only a very small number of Russians dream of unity with Europe. Lukin did not expect this trend to reverse anytime soon.

## Book Talk

### RENMINBI RISING: A NEW GLOBAL MONETARY SYSTEM EMERGES

**Dr. William Overholt**

Senior Fellow, Harvard University Asia Center

**February 10, 2016**

Along with China’s rise to the second largest economy in the world is the rise of its currency, the Renminbi (RMB). This was accentuated by the IMF agreement in October 2015 to add it into the prestigious club of Special Drawing Rights (SDRs) as the world’s fifth “hard currency” after the U.S. dollar, the euro, the British pound and the

Japanese yen. What does it mean to be an international hard currency? What has led to RMB’s ascendance? What are the implications for the global monetary system? Dr. William Overholt explained the dynamics underlying RMB’s rise and obstacles confronting its internationalization, postulated China’s motivations, and contemplated the prospect of RMB’s rise from the point of view of governing the global economic and political system. His talk was based on his recently published book *Renminbi Rising: A New Global Monetary System Emerges*, authored with Guonan Ma and Cheung Kwok Law.

Overholt started his presentation with the 2008 financial crisis, which originated in the U.S. One of the world-wide reverberations of this crisis is that it led China and some other countries to believe that the dollar-based global monetary system was too risky. The U.S. collapse created huge disruptions for China and, with its foreign exchange reserves stuck in U.S. dollars, China stood to take huge losses. On the other hand, if China could hold more assets in its own currency, and if more international trade deals were settled in the RMB (shifting exchange rate risk from Chinese companies to their foreign trading partners), if major commodities were denominated in the RMB, and if the Chinese large foreign reserve piles were more diversified, instead of mostly concentrated in dollar-denominated assets, the Chinese economy would not be as adversely affected by this financial tsunami as it was.

Why would the Chinese government push to internationalize the RMB, whereas Germany and Japan in the similar developmental stage did the opposite? In addition to wanting to reduce the risks mentioned above, Chinese

Continued on page 27

Continued from page 26

leaders intend to use the process of internationalizing the RMB as an opportunity and lever to push along other reforms at home, just as Premier Zhu Rongji did with China's WTO negotiations in the 1990s. They also believe that internationalizing the RMB would enhance China's prestige in the perception of foreigners, while being realistic that the RMB cannot displace the U.S. dollar in the world monetary system in the foreseeable future.

Thus the Chinese government became more determined to push RMB's internationalization by encouraging wider global use. To internationalize the RMB is to persuade foreigners to be willing to use and hold the RMB. To do this, China has to have a large and growing economy with deep and open capital markets which foreigners can easily access, and it must have trusted institutions ensuring smooth functioning of markets, including independent judiciaries for financial disputes. This latter point, according to Overholt, poses the most fundamental obstacle for making the RMB a competitor to the U.S. dollar, especially as a reserve currency, since it requires a shift from China's conventional Communist Party dominance of legal decisions.

To open its capital markets, China has gradually relaxed restrictions on its capital accounts since the beginning of the 21st century through a series of programs such as Qualified Foreign Institutional Investor (QFII), Qualified Domestic Institutional Investor (QDII), Renminbi Qualified Foreign Institutional Investor (RQFII), and Renminbi Qualified Domestic Institutional Investor (RQDII) to allow more cross-border capital movement. However, China still has some way to go to completely open its capital accounts.

China's bond markets are getting deeper but the size of the Chinese bond market is just a bit over 10 percent of that of the U.S. Even if China did everything right, its bond market would still lag far behind the sizes of the U.S. and Japan's bond markets in the next five years. Moreover, the bond market is divided into four parts by four different regulators, so its effective size is much less even than the 10 percent level. In the coming years, China could unify its bond markets; it could greatly expand them by incorporating more local government debt into central government bonds and by shifting its financial system from over-reliance on bank lending to greater use of stock and bond markets.

Successful RMB internationalization requires continued Chinese success at economic growth. In recent years, China's economic growth prospect has dimmed as it encounters some headwinds. China has to transition from an export, manufacturing and investment-driven economy to an economy primarily driven by domestic consumption, and become more service-oriented; from emulating technologies of advanced economies to genuinely innovating technologies. These are tall orders by any means, especially when they involve major structural and cultural shifts in a context of overall financial squeeze and serious overcapacity in many heavy industries. On top of these challenges, China has an aging population that reached the Lewis turning point in 2010. (Named after economist W. Arthur Lewis, it is a term used in economic development to describe a point at which surplus rural labor reaches a financial zero). A weaker Chinese economy has engendered a fear of capital flight, which can be self-

Continued on page 28

Continued from page 27

fulfilling. China's foreign reserves have shrunk by about \$800 billion, i.e., 20 percent, from their peak in 2014. Nevertheless, Overholt did not expect any hard landing in the foreseeable future. He only anticipated a slower annual growth of about five to seven percent for the next five years and then five percent or less from 2020 onward.

The RMB's joining of the SDR (Special Drawing Rights), according to Overholt, is of great symbolic significance to China since it represents an acknowledgement by the IMF of China's market reform progress, but the SDR membership has limited practical implications. There were less than 300 billion USD of SDR distributed as of June 2015, which is very small compared with the size of total official reserves held by monetary authorities around the world.

How important is the RMB becoming in various product markets? In trade finance, it is now the world's number two currency, with eight percent of the world market in 2013, but the U.S. dollar (USD) is still 81 percent. In overall payments, the RMB was two percent in 2014, a doubling from 2013, whereas the USD was 45 percent. In foreign exchange trading, the RMB, inhibited by China's capital controls, was two percent of global trading in 2014 while the USD was 87 percent, but the RMB's rise is spectacularly fast, gaining 249 percent from a low base in 2010-2013. As a reserve currency, the RMB is about one percent of total global reserves; on optimistic assumptions it could be as much as five percent by 2020.

The biggest changes wrought by China in global monetary affairs concern the institutional structure, and they actually have more to do with U.S. decisions than with China's rise. The U.S. Congress' rejection in 2009 of

plans to further capitalize the World Bank and reform its governance gave China further impetus and time to initiate some institutions with global significance including the BRICS Bank, the Asia Infrastructure Investment Bank (AIIB) and the Silk Road Fund. The establishment of these institutions served a vital Asian need for infrastructure financing and also catered to the wide-spread dissatisfaction that many countries felt, after the Asian financial crisis of 1997-98 and the global financial crisis of 2008-09, with the global financial management structure underpinned by the Bretton Woods institutions and the U.S. dollar. Overholt argued that refusing to modernize the Bretton Woods institutions, and then refusing to join the new, bigger institutions, maximized the damage to U.S. influence and maximized China's rising influence in global monetary affairs. The U.S. Congress' acceptance of World Bank reforms in 2015 came too late, particularly when the U.S. remains outside the AIIB.

Overholt concluded that the emergence of the RMB in the global market is rapid and significant, even though the U.S. dollar and the Federal Reserve will remain preeminent for the foreseeable future. Whether those international institutions initiated by China will compete against or complement the Bretton Woods institutions depends on the leadership of China and the U.S.

## THE TAIWAN ELECTIONS AND CROSS-STRAIT RELATIONS: WHAT NEXT?

**Professor Steven M. Goldstein**

Sophia Smith Professor of Government, Smith College; Associate, Fairbank Center

**February 17, 2016**

The “magic” word most frequently used to refer to cross-strait relations is “status quo.” Both Taiwan and mainland China claim to try to maintain the status quo, while each side criticizes the other for changing it. What does “status quo” mean in the context of the cross-strait relations? How is it changing? What might happen next? Steven M. Goldstein parsed the rhetoric of each side, delved behind the facade of a seemingly successful institutional infrastructure built over the past eight years to facilitate trade and cultural exchanges, and revealed a worrisome dynamic leading toward increasing instability across the Taiwan Strait in the near future.

Goldstein viewed “status quo” as a spectrum, with stable status quo at one extreme and conflicted status quo at the other extreme, with unstable status quo in the middle. A stable status quo is characterized by agreement by all sides on the nature of the disputed issues and the rules to manage them. A conflicted status quo is the opposite, with no agreed rules or institutional guarantees, where a danger of blowing up the dispute into crisis is always present. An unstable status quo refers to a situation where all involved parties really have different ultimate objectives in mind but choose to grudgingly accept the current situation because they either believe that the cost of changing the situation is too high, or believe it may

eventually promote their ultimate objectives. By these definitions, situations in the South China Sea and East China Sea are clearly conflicted status quos.

Taiwan’s situation is different, according to Goldstein. Since President Ma Ying-jeou took office in 2008, there has been a swath of new rules and institutions erected to promote and govern increased interactions with the mainland. Both sides seem to be managing buoyant cross-strait activities with deeper understanding. A successful enterprise seems to have been created to maintain peace. But underneath this rapprochement are rising concerns on both sides that this infrastructure has not fulfilled the expectations of either side; furthermore, it has weakened their respective ultimate objectives.

What are their respective objectives then? Beijing wishes to eventually incorporate Taiwan into the People’s Republic of China (PRC) by winning the hearts and minds of the Taiwan people through intensifying economic and cultural relations, thereby fostering a shared Chinese identity and mutual benefits. But a reputable public opinion poll in 2015 shows that a majority of Taiwan’s people consider themselves Taiwanese, ethnically separated from China. On the spectrum characterizing cross-strait relations from “one state on either side of the Taiwan Strait” all the way to “a united China,” roughly 70 percent of the Taiwan people support the former extreme; less than 20 percent support the latter extreme. These polls all indicate that the mainland has not gotten any closer to its objective after eight years of expanded trade and cultural exchanges, and that a deep distrust of the mainlanders still remains in Taiwan.

Continued on page 30

Continued from page 29

On the other hand, Taiwan's wish of maintaining its independent sovereignty, expanding its international space and resisting any closer integration with the mainland is not fulfilled either. Taiwan took a gamble eight years ago in the interest of maintaining peace and advancing economic prosperity, but the current mood is disillusionment and caution regarding further entanglement with the mainland, as demonstrated by the Sunflower Movement of 2014 and 2015 and the election results. The Sunflower Movement is associated with a protest movement driven by a coalition of students and civic groups that came to a head in 2014 and 2015 in the Taiwanese Legislative Yuan and, later, also the Executive Yuan.

Thus, both sides feel that they have regressed vis-à-vis their respective ultimate objectives. This has the potential of leading to a more conflicted status quo. The recent election of Tsai Ing-wen from the Democratic Progressive Party (DPP) as Taiwan's next president highlights this incompatibility. It is not an isolated event, but a culmination of a long process simmering underneath the cross-strait advances of the past eight years.

For the future, Beijing has made it clear that it would not deal with any party which does not accept "the 1992 Consensus," which Beijing considers as the political foundation for cross-strait relations. During the past eight years of the KMT administration, both sides accepted this consensus as expressing a one-China formula but with different interpretations. Beijing's interpretation was that there is only one China, Taiwan is part of China, and sovereignty cannot be separated. Taiwan's interpretation was that the Republic of China (ROC) has been an

independent, sovereign entity since 1912, and that the mainland is part of the ROC.

Tsai Ing-wen cannot accept the 1992 Consensus both because it is inconsistent with her party DPP's ideology and because it is against the opinion of a majority of the Taiwan people. What can she do when Beijing refuses to talk with her? Near the end of her presidential campaign, she acknowledged that the 1992 meeting was a historical fact in which both sides set aside their differences in order to move forward their relations. In a more recent news article by the *Liberty Times* on January 21, 2016, she is reported to have "understood and respected the common understanding" achieved at the 1992 meeting, which formed the basis of many agreements reached ever since.

Since Tsai Ing-wen's election, Beijing's response has been ambiguous. Goldstein warned that to avoid moving to a conflicted status quo, a new fig leaf has to be found to cover differences over one China, similar to the 1992 Consensus, to satisfy both sides, and to establish the basis for a new status quo in the current tenuous situation.



# CHINA AND THE U.S. REBALANCE TO ASIA: RECENT RESEARCH ON BEIJING'S RELATIONS WITH AUSTRALIA, INDONESIA, MYANMAR, AND VIETNAM

**Dr. Bates Gill**

Professor of Asia Pacific Strategic Studies,  
Strategic and Defence Studies Center,  
Australia National University

**February 24, 2016**

In his talk, Dr. Bates Gill presented the results of a two-year study on emerging U.S. security partnerships in Southeast Asia, focusing on Myanmar, Indonesia and Vietnam. Drawing from the findings of the study, and also speaking from his observations in Australia, he spoke about how these countries are looking to balance their security relations between the U.S. and China and the challenges in turn for Chinese foreign relations with these countries.

At present, Myanmar faces no major external threat and continues to maintain its long-held preference for neutrality and non-alignment. The steady opening of the country to the West since 2011 and the historic election of November 2015 have had a substantial impact on the country's strategic outlook, including loosening dependence on China. Its main security challenges are internal: how to deal with armed ethnic groups around its borders and how to strengthen its "state building" capacity.

China's ties with some of the armed ethnic groups, especially the Kokang, have contributed to a significant deterioration in Myanmar-China relations in recent

years, in spite of a "comprehensive strategic partnership" established between them in May 2011. In addition, Myanmar elites and the wider public harbor a persistent mistrust of China and are wary of overdependence on Beijing. In the meantime, Myanmar-U.S. relations have entered a growing rapprochement as the country gradually opens up to the West.

Like Myanmar, Vietnam has a generally good external security environment. Its security challenges mainly involve a long-term existential concern of bordering China, an enormous and powerful country. Its relationship with China is complex. On the one hand, it proclaims some affinity to China, especially between the Communist parties. On the other hand, China has historically presented a perpetual threat to Vietnam, accentuated in the current period by territorial disputes over the Paracels and the Spratly Islands in the South China Sea. This dispute became especially acute with the Chinese deployment of an at-sea oil rig platform in 2014 in waters claimed by Vietnam.

Vietnam deals with China for the most part through cautious "neutralizing and ritualizing," as termed by Professor Brantly Womack of the University of Virginia. "Neutralizing" means looking to diffuse tensions with China; "ritualizing" means doing so through traditional forms of diplomatic and party-to-party contact. Because the Communist Party of Vietnam (CPV) is primarily concerned with maintaining regime legitimacy through economic development, China's challenges to Vietnamese sovereignty are especially irksome as they can undermine CPV standing domestically.

Continued on page 32

Continued from page 31

Like Myanmar and Vietnam, Indonesia has a relatively benign security environment, with no direct threat to its territory. Under its “free and active” foreign policy, its main security concerns are the possibility of conflict between the U.S. and China as well as possible disputes among South China Sea claimants. Indonesia has no territorial disputes with China, but China’s “nine-dashed line” appears to overlap with the Natuna Islands’ exclusive economic zone (EEZ) in the South China Sea.

Traditionally, Indonesia has had much closer relations with the U.S., across diplomatic, economic, military, and people-to-people arenas, than with China. China has much catching up to do. There is still lingering mistrust of China amongst Indonesian elites dating back to the 1960s. While its trade relations with China have been growing, its relations on the investment side have not grown as quickly. A more powerful China will be viewed by the Indonesians as more of a threat than the more familiar U.S. presence. Overdependence on China will face a public backlash in Indonesia.

Australia is also in a relatively benign security environment, but its dependence on trade makes it highly sensitive to the regional power balance and to its U.S. alliance since any power change will affect its trade relations and economic interests. With China’s rise, Australia confronts the challenge of how to strike the right balance between Washington and Beijing.

China is Australia’s largest trade partner with one-third of Australian exports going to China and one-fifth of Australian imports coming from China, but their investment relations lag behind their trade relations. Gill predicted that Australia is likely to become an increasingly

important security partner to the United States. The U.S. has already expanded its military and intelligence presence in Australia.

In conclusion, Gill summarized the commonalities among all these countries. As China’s economic growth slows and the South China Sea disputes intensify, all of them have begun to re-think their strategic relations with China. They all share a growing wariness about a rising China, though that caution is stronger in countries such as Myanmar and Vietnam. They all fear overdependence on China economically. Each of these countries—along with many others in the region—is employing different approaches to “engaging and hedging.” They do so by diversifying their economic and security relations, which includes increasing their alignment with Washington. It appears that Beijing has misread some of the domestic political signals in these countries. This has made it more difficult for China to pursue a more positive image in the region.

## THE TRANS-PACIFIC PARTNERSHIP AND ITS IMPLICATIONS FOR CHINA

**Professor Mark Wu**

Harvard Law School

**March 2, 2016**

In October 2015, trade ministers from 12 countries in the Pacific Rim, representing almost 40 percent of global GDP, forged an agreement on the Trans-Pacific Partnership

Continued on page 33

Continued from page 32

(TPP). President Barak Obama, in his State of the Union address in January 2016, emphasized that the TPP was important because it allowed the U.S., not China, to set trade rules in the region. Does this imply that the TPP is an effort to contain China? China, meanwhile, is engaged in negotiating another regional free trade agreement (FTA), the Regional Comprehensive Economic Partnership (RCEP), with 15 countries in Asia. Does this indicate a possible separation of the Asia-Pacific into two trade blocs, led by

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**What is the driving force for the TPP? Part of the calculus is geostrategic. Beyond that, there is a misconception that the U.S. and Japan felt it necessary to do a deal to reverse their declining shares of world trade. Wu showed data that in fact the total trade shares of these two countries have held quite steady; only specific industries of these countries, such as manufactured goods, have suffered declines in trade volumes.**

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two world powers, in a style reminiscent of a new Cold War? This concern is not limited simply to trade. It has become more salient in Asia, after the U.S. decided not to join the Asian Infrastructure Investment Bank (AIIB), an international bank initiated by China outside of the World Bank system.

What is the future of how trade will be governed in Asia? Will China eventually choose to join the TPP?

What are the economic consequences for China if it does not join the TPP? What does this mean for the World Trade Organization (WTO)? Mark Wu addressed these questions in his presentation and clarified several common misconceptions about the TPP.

The TPP builds on the existing architecture of trade deals in Asia. The U.S. already has FTAs with many of the TPP member countries, as do Japan and Australia. However, not every TPP member country has a FTA with every other TPP member country. So this trade deal fills in the missing links and deepens the integration among the TPP countries.

What is the driving force for the TPP? Part of the calculus is geostrategic. Beyond that, there is a misconception that the U.S. and Japan felt it necessary to do a deal to reverse their declining shares of world trade. Wu showed data that in fact the total trade shares of these two countries have held quite steady; only specific industries of these countries, such as manufactured goods, have suffered declines in trade volumes. Furthermore, the WTO's Doha Round has stalled after 14 years of negotiations, giving impetus to negotiating regional FTAs, including the TPP.

Second, the TPP is an open architecture agreement, which allows any country to apply and accede, as long as it accepts a broad baseline of standards and procedures in addition to lowering tariffs. This broad baseline ranges from market access to environment standards, labor standards, sanitary and phytosanitary standards for food, protection of intellectual property rights, competition policy, rules on state-owned enterprises (SOEs) and government procurement.

Continued on page 34

Continued from page 33

Since the tariffs of most of the member countries in most areas are already very low, the TPP is primarily about reducing tariff peaks and leveling the playing field in these other areas. The TPP also subjects member governments to an Investor-State Dispute Settlement (ISDS) mechanism, so that investors can sue foreign governments for unfair or discriminatory treatment. Because the TPP has an open architecture, it cannot be said that it is an intentional effort to exclude China and to contain it. South Korea and some other Asian countries that were not originally included are now contemplating the pros and cons of joining the TPP. China too could do so, if it decided that it was in its interests. The issue is whether that will ever be the case.

Third, the TPP and the RCEP should not be conceived of as deals designed to forge two opposing camps led by two big trading powers, reminiscent of a new Cold War. There are seven countries that are involved with negotiating both trading deals: Australia, Japan, New Zealand, Brunei, Malaysia, Singapore and Vietnam. There is no barrier preventing a country from joining both arrangements.

How would some aspects of the TPP affect the Chinese model of economic governance? For example, the TPP rules require member governments not to give non-commercial assistance to their SOEs which would have adverse effects on private companies, domestic or foreign, in the same industry. These provisions also subject member governments to state-to-state dispute settlement mechanisms. But these provisions may not necessarily be prohibitive for China to join the TPP, at least in theory. According to Wu, exceptions for any particular SOE or in any particular industry can be negotiated and listed in a separate annex attached to the final agreement. The

question, were China to apply to join, is whether the other TPP countries would be willing to grant such exceptions. Similarly, the TPP rules on competition policy, requiring procedural fairness, transparency of decision-making, and cooperation among antitrust authorities, are also not necessarily too demanding for China to accept. Chinese antitrust laws already have several of these elements, at least on paper. A bigger problem for China is whether its application of such laws is fair and transparent. The provisions that pose the biggest problem for China in Wu's view are the TPP rules that guard against restrictions on the free flow of data. China would likely consider such a requirement to exceed the bounds of what it would accept for internet governance, as it might be deemed to pose a security threat.

Will China apply to join the TPP? Wu believed that the incremental benefits from the TPP for China are small. China already has FTAs with 12 countries and is engaged in trade negotiations with several more countries under the RCEP. The only countries in the TPP that don't have FTAs with China and are not part of the RCEP are the U.S., Canada and Mexico. Furthermore, the TPP rules on how to determine a product's country of origin in a globalized supply chain can benefit some Chinese export industries even without China's membership in this club, such as Chinese auto parts suppliers. Thus, the economic cost to China of remaining outside of the TPP is likely to be insignificant; some other analysts have suggested it may be less than 0.1 percent of Chinese GDP.

At present, the TPP has not been ratified yet by the legislature of any of the 12 member countries. Only if all

Continued on page 35

Continued from page 34

member countries ratify it, or at least 6 of them, representing 85 percent of the total GDP of the original signatories, ratify it after two years, will the TPP enter into force. How the U.S. Congress will vote on this in a presidential election year is tricky and uncertain, but the result will be consequential. It will influence the attitudes of other member countries' legislatures, as well as countries outside the TPP which may aspire to join if the TPP enters into force. It will certainly impact the economic and political calculations of the members of the RCEP and their pace of negotiations.

Wu concluded that the TPP is not an effort to contain China; China has no urgent need to join the TPP; the negative economic impact for China to remain outside of the TPP is very small; the TPP to China now is not like the WTO accession to China in the 1990s, which the Chinese leaders used as a lever to embolden domestic economic reforms. The proliferation of regional FTAs like the TPP and the RCEP, as well as sector specific (e.g., info-tech goods or environmental goods) trade agreements imply that the probability of resuscitating the Doha Round of the WTO has become slimmer than ever before. Wu anticipated an increasing fragmentation of international trade law with the WTO agreements only serving as the baseline rules for global trade.

## CHINA AND GLOBAL FINANCIAL MARKETS: A CLASH OF CIVILIZATIONS?

**Dr. Scott Kennedy**

Deputy Director, Freeman Chair in China Studies; Director, Project on Chinese Business & Political Economy, Center for Strategic & International Studies (CSIS)

**March 9, 2016**

It was about this time in 2015 when the U.K. announced that it would join the China-initiated Asia Infrastructure Investment Bank (AIIB), which triggered several western countries to follow suit, adding up to the current membership of 57 countries. Some Americans immediately assailed the U.K. as a traitor of our alliance, while regarding the AIIB as a revolutionary anti-status quo international institution that together with other Chinese-led initiatives could undermine the long-established international economic order. But such pungent criticism is much exaggerated by the media and other analysts. Dr. Scott Kennedy analyzed the reasons for this tension from both China's side and from certain features of international regimes.

Kennedy began by summarizing China's involvement in the international system in the post-Mao era into one word: integration. In his view, China's integration into the post-World War II world order continues to be the dominant trend today. China has been on a steep learning curve since it joined many international economic institutions in the 1980s as well as when it applied to join

Continued on page 36

Continued from page 35

the GATT (General Agreement on Tariffs and Trade) in 1984. Initially, the Chinese representatives listened attentively and took notes assiduously in the meetings. They were aware of the formal rules, but not of informal rules based on people's tacit understanding of conventions evolved through socializing such as going together to coffee or

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**China believes in the power of the state and is not supportive of independent NGOs. Hence, it is more comfortable in state-based international institutions as opposed to private, non-state governance mechanisms.**

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fishing or playing golf. Since the Chinese were not part of these international social circles, they didn't really have any influence in the decision-making processes.

But over time, they have developed a voice and have taken more leadership positions in international institutions. Then the question is, what would the Chinese say in these leadership positions? As it turned out, their positions are not very different from North Atlantic countries, in contrast to their counterparts from India, who often take more radical positions. Ms. Zhang Yuejiao from China is one of the seven members of the WTO's Appellate Body dispute settlement (2008-2016). She is so deeply familiar with international trade law that she is indistinguishable from other competent WTO judges. Similarly, Yi Xiaozhun from China, one of the four Deputy Director-Generals of the WTO, operates with no distinct Chinese characteristics in his professional capacity. China sometimes proposes reforms to international institutions,

but those are not radically different from what North Atlantic countries would propose.

However, some tensions with other countries arise from certain features of the Chinese side. First, China's government heavily intervenes in the market with a wide assortment of industrial policy tools, believing that market failure is more likely to happen than government failure. Such policies are intended to help domestic Chinese industries, especially state-owned enterprises. Second, as an authoritarian country, China believes in the power of the state and is not supportive of independent NGOs. Hence, it is more comfortable in state-based international institutions as opposed to private, non-state governance mechanisms.

The other source of tension comes from certain characteristics of international regimes. International institutions, including the WTO, are not uniformly liberal and permit protection of domestic industry for reasons of environmental protection, public health, or national security. In addition, the usage of these rules requires strategic skill. Finally, there are many areas of the international economy where there are no rules, and in such circumstances, the disagreements between different countries becomes political quickly because there are no internationally accepted rules on which to base disagreements. The trade sphere has clearer rules, and their conflicts are more manageable. Even in trade remedies, the Chinese have learned to lawyer up and can defend themselves and accuse others as well as anyone.

But in international finance, there are no clear rules, and the norms are quite vague, leading to more

Continued on page 37

Continued from page 36

heated conflicts. For example, on cross-border investment, there is no world investment organization, although the WTO agreement on Trade-Related Investment Measures (TRIM) does forbid governments' demand of foreign technology in return for allowing foreign investment. On anti-trust issues, there is the International Competition Network, but it is just a talk shop and has no governance authority. In national security and investment, there is no agreed-upon standard. The U.S. has its own Committee on Foreign Investment in the U.S. (CFIUS), but it is rooted in U.S. law and has no international norms. Hence, there have been a series of fights over blocked Chinese investments.

Another example of lacking well-defined rules is in the criteria for a currency to join the Special Drawing Rights (SDR) of the IMF. Formally, a currency must be widely used and freely usable in order to be part of the SDR. But the definition of "freely usable" is not completely clear. The Japanese yen joined the SDR in 1980, about 12 years before its capital account was opened. China made it a priority for the RMB to join this exclusive club of the SDR, presumably for its prestige more than anything else, as the fifth currency after the U.S. dollar, the euro, the British pound and the yen. The IMF, with support from the U.S., gave its nod to this Chinese initiative last November as a gesture of support for Chinese economic reforms.

Similarly, there is no consensus on what kind of exchange rate regime a country should have. Generally speaking, large important countries should have a flexible exchange rate regime. But this is not a rule; furthermore there is no definitive way to determine when a currency is undervalued. China was praised for holding its currency steady during the Asian financial crisis of 1997-98, when

many Asian countries were in competitive devaluation. Now it's facing downward market pressure again. How the RMB exchange rate is set matters significantly to the rest of world because China is the second largest world economy, and its capital account is partially open. Large amounts of capital can go in and out of China relatively quickly, affecting financial markets around the world. When the RMB suddenly depreciated by about four percent in August 2015, it made world markets tremble. In December 2015, the Chinese central bank announced that the RMB would be pegged against a basket of 13 currencies. But it has not tracked this basket well in retrospect. In February of this year, Zhou Xiaochuan, the Chinese central bank governor, said in an interview that it would only use the basket of currencies as a reference, not an anchor for pegging. Thus it is still not clear how China sets its exchange rate policy. It looks even more cloudy when one takes into account that the Chinese central bank is not as independent of the government as the Federal Reserve is in the U.S., and does not operate as predictably and transparently as the Federal Reserve does.

Kennedy expected this opacity of Chinese economic policy-making and the lack of clear rules in the world of international finance to continue indefinitely. He anticipated a clash of civilizations to emerge between the Chinese model of economic governance and what is needed to facilitate international finance, while global trade and investment are adversely impacted by increasing volatility in this murky and uncertain world.

# THE CHANGING DYNAMICS OF U.S.-CHINA RELATIONS AND THE FUTURE OF AMERICA'S CHINA POLICY

**Dr. Evan S. Medeiros**

Managing Partner, Eurasia Group; former Senior Director for Asia, U.S. National Security Council

**March 23, 2016**

How have U.S.-China relations evolved in recent years from the perspective of someone in the driver's seat of America's Asia-Pacific relations? What does the control panel for these relations look like? What are the primary driving forces behind them? And what do they mean for U.S. policy toward China? Dr. Evan S. Medeiros addressed these questions from his prior experiences at the center of the policy making world, across the areas of diplomacy, defense policy, economic policy, and intelligence affairs in the Obama Administration.

Medeiros identified six trends in U.S.-China relations. First, there is a profound uncertainty among U.S. policymakers about China's future. China could either move along a trajectory of moderate economic growth, political stability and military modernization, or experience an economic hard landing and incur miscalculation or missteps in political and military areas; both trajectories have risks for the U.S. No other country's future trajectories are as drastically different as China's. Which scenario will occur depends on China's ability to balance competing interests and objectives – political, economic, diplomatic and military. What is certain is that the U.S. and China will be probing for a new strategic modus vivendi to guide this relationship,

which will not be hashed out in any negotiation process, but will emerge through cumulative interactions between both sides in somewhat haphazard ways.

Second, despite the inherent instability in U.S.-China relations due to long-term mistrust and different world views (with substantial sources of competition), U.S.-China relations have become more resilient as problems in

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**China has stepped up to the plate and started contributing to the global public good with international norms and standards.**

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any one area tend to be compartmentalized without spill-over effects into other areas. This is a healthy trend. It does not mean that the bilateral relationship is free of problems, but does mean that it will endure most disruptions in any of the subject areas—cyber security, Taiwan relations, Tibet autonomy and many other areas.

Third, U.S.-China relations have become more mature in the past four decades. Over the ensuing 44 years, both sides have learned a lot about each other and more intensively in recent years at a higher level of government interaction. President Obama met his Chinese counterpart more times in the last seven years than his predecessors did in 30 years. Not only through state visits, they also met on the side of many multilateral meetings, such as the G20 and the APEC. Meetings at vice premier and ministerial levels are much more frequent through many more venues. These meetings have enhanced clarity, consistency and predictability of policies in both countries.

Continued on page 39



Continued from page 38

Fourth, the issues covered in the purview of this bilateral relationship have multiplied and become much more diverse. This means more complexity in trade-offs between policies and in prioritizing issues and objectives for policy makers. While this diversity of issues increases the possibility of policy failure in any one of the subject areas, it also opens up more opportunities for bilateral cooperation. One example is in the area of clean energy and climate change, where the Chinese, motivated by their own domestic needs, approached the Americans for help.

Fifth, the U.S. recognizes that there is space for China to play a more important role in international affairs; China has stepped up to the plate and started contributing to the global public good with international norms and standards. Although the ultimate impact of China's integration into the world is yet to be determined conclusively, China has participated in many international organizations, such as the WTO, making positive impacts so far.

Sixth, there is always a domestic dimension on foreign policy. The extent of China's economic slowdown, layoffs from enterprises with excess capacity, challenges from economic restructuring and political campaigns, such as anti-corruption, can all threaten the regime's security, foment nationalism, and worsen the victim mentality from China's modern history. This could motivate China to take steps in foreign policy in directions that it wouldn't have done otherwise.

In addition, the political economy in many parts of the world has changed as well. In the U.S., there is a strand of anti-free trade and globalization; such voices are particularly strident in a presidential election year.

While local leaders of American cities and towns welcome Chinese investments for creating jobs, other Americans are suspicious about the background and the motivation of large sums of Chinese money coming into the U.S. Furthermore, the American business community is no longer a champion of promoting U.S.-China relations, as its enthusiasm about going into China is dampened by Chinese policies alienating foreign companies, especially in the IT sector.

In Asia, China and Japan's ties remain tense due to historical animosity and economic disparity, and they find themselves competing for parity in many spheres, including opportunities for financing infrastructure projects abroad. America's five traditional allies in the Asia-Pacific (Japan, South Korea, Australia, the Philippines and Thailand) are forging relations among themselves, as they try to mitigate their reliance on China amid a general economic slowdown around the globe.

Medeiros concluded that all of these dynamics imply that a certain amount of instability is part and parcel of U.S.-China relations, and that a mixture of elements of cooperation, competition, distrust and even some rivalry exist in this bilateral relationship. He warned that while the U.S. acknowledges China's role in international affairs and allows China a seat at the table, the U.S. needs to make sure, through expanding engagement in all areas, that China continues to contribute to global public goods and norms in collaboration with other countries.

## WITHER CHINA'S ECONOMY

**Pieter P. Bottelier**

China Studies Visiting Scholar, School of  
Advanced International Studies (SAIS), Johns  
Hopkins University

**March 30, 2016**

Having grown so fast and become the world's largest trader and second largest economy, China is now the number one change factor in the global economy. In his presentation, Pieter Bottelier enumerated challenges confronting China's economy and expressed concerns for its unclear future. Accumulating economic problems might overwhelm the system or cause significant long-term under-performance. Bottelier admitted that he was less optimistic than he used to be, but did not think that the challenges were insurmountable, nor did he see a disaster on the immediate horizon. He believed that China's growth potential remains good, but emphasized that leaders should be more determined to implement urgent structural reforms and rectify system inconsistencies.

Having served as chief of the World Bank mission in Beijing in the 1990s, Bottelier was nostalgic of a bygone era when China undertook major institutional and economic reforms under the leadership of President Jiang Zemin and Premier Zhu Rongji. During that period, thousands of state-owned enterprises (SOEs) were restructured, closed or privatized; large numbers of laid-off workers were absorbed in the rapidly growing private sector, while urban residences were "sold" to occupants far below market value. Through this housing privatization, a

huge amount of wealth was transferred from the state to urban residents, which facilitated the growth of a mobile urban middle class. Adaptations in trade and investment policies and laws were triggered by China's entry into the WTO in 2001. China was then eager to make friends abroad and learn from more advanced economies.

In contrast, the spirit of Deng Xiaoping and the courage to implement tough reforms now seem to have vanished. Reforms in key areas, e.g. inefficient SOEs, have been lagging. This may be due to the inherent conflict in two key 3rd Plenum "decisions:" reserving a "dominant" role for the state in the economy, while simultaneously assigning a "decisive" role to the market in allocating resources. Moreover, President Xi Jinping seems to indulge adulation of his person, while concentrating much power in his own hands and frustrating institutional development (including rule-of-law and freedom of speech). To Bottelier, the government's top priority seems no longer to be economic development, but the pursuit of national grandeur and party power. Furthermore, the external environment is not as favorable for China's economic development as it was in the 1990s and early 2000s.

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**...China's foreign exchange reserves shrunk from almost four trillion U.S. dollars (USD) in mid-2014 to the current level of about 3.2 trillion USD.**

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All of the above, combined with excessive credit expansion (and the emergence of large-scale shadow banking)

Continued on page 41

Continued from page 40

following the 2008 global financial crisis, underlies the recent economic slowdown. Major challenges include an excess supply in urban real estate markets, over-capacity in coal mining and heavy industries, over-leveraging of many SOEs and local governments. The “One-Belt, One Road” initiative and government efforts to promote domestic and international corporate mergers may eventually absorb some excess capacity, but the problems are very pressing and require other solutions as well. To tackle local government debt problems, Beijing amended the Budget Law, allowing provincial governments to issue municipal bonds. To reduce corporate debt, the government is planning to encourage debt-equity swaps. To reduce the supply overhang in commercial real estate, the government is experimenting with subsidies to migrants for the purchase of empty apartments.

However, these remedial measures are unlikely to be effective. Bottelier pointed to the danger of relying on additional credit expansion to counter the ongoing economic slowdown. Since the central government’s debt and overall budget deficits are relatively modest, he stressed the importance of fiscal policy to stimulate the economy. He thought that current economic challenges were solvable, provided the government addressed structural problems in the economy more systematically and forcefully.

In spite of large current account surpluses and net foreign direct investment (FDI) inflows, China’s foreign exchange reserves shrunk from almost four trillion U.S. dollars (USD) in mid-2014 to the current level of about 3.2 trillion USD. This is still a huge sum by traditional IMF standards, but not adequate if investors lose confidence in

the economy. It is difficult to untangle the causes for the unusually large (about one trillion USD) capital outflow from China from mid-2015 through February 2016. However, it is likely that, apart from legitimate portfolio diversification, external debt pre-payments and changes in liquidity management by multinational corporations in China, there was an element of capital flight related to confidence problems. If large capital outflows continue, China could be forced to impose additional capital controls or allow for significant RMB depreciation.

Bottelier disputed that demographic factors had much to do with the recent economic slowdown. Although the national labor force is indeed declining (after peaking around 2012), the work force in urban China (accounting for 80-85 percent of GDP) is still growing. Since the supply of labor is decreasing faster than demand, labor markets generally remained relatively tight, allowing for continued real wage growth and thus for a rising share of household incomes in GDP, which helps rebalance the economy by promoting consumption.

Other positive factors underlying China’s decent growth potential include a high savings rate, a well-educated labor force, a competent civil service, abundant entrepreneurial talent, active promotion of domestic innovation and relatively good infrastructure. The key question to Bottelier is whether China’s leaders are prepared to assign higher priority to the difficult but necessary structural economic and system reforms as outlined in the “decision” of the 3rd Plenum of November 2013.

## SCIENCE AND TECHNOLOGY IN THE MAKING OF MODERN CHINA: FROM GIST GEE TO DR. TU YOUYOU

**Professor Lawrence Sullivan**

Adelphi University

**Dr. Nancy Liu-Sullivan**

College of Staten Island

**April 6, 2016**

In the late 19th century and early 20th century, some Chinese elites considered learning western science and technology as a way to modernize China. But when Gist Gee, a Methodist missionary from South Carolina, arrived in China in 1901, and taught all kinds of science courses in Dongwu University in Suzhou, including chemistry, physics, zoology, physiology, botany, geography and agriculture, few Chinese students were enthusiastic about these subjects, unconvinced about the future use of this body of scientific knowledge. And this was before the abolition of the civil service examination system in 1905.

Professor Lawrence R. Sullivan delineated the lives and the contributions of some distinguished Chinese scientists through the vicissitudes of China's contemporary history, and expressed a deep concern of many current Chinese scientists—what would happen to them if there were another cultural revolution or incessant political campaigns? Who would be the next victim? Whereas he focused on the impact of China's political events in the 20th century on the scientists, Dr. Nancy Liu-Sullivan gave a succinct account of some scientific accomplishments in China in the 21st century, featuring Nobel Prize winner

Dr. Tu Youyou's discoveries and Beijing Genomic Institute (BGI)'s pioneering work in genome sequencing.

According to Professor Sullivan, China's acquisition and adaptation of modern science and technology was uneven across time and subjects. Albert Einstein visited China in the early 1920s, but his theories of relativity were not accurately translated or comprehended. In the 1940s and 1950s, many western-trained Chinese scientists returned to China and made significant contributions to China's scientific development. Qian Xuesen was such a "gift" from the West to China. The anti-communist McCarthy era propelled some of the best Chinese scientists to leave the U.S., Qian was one of them. He moved from the Jet Propulsion Laboratory, which he helped found in the U.S., to the Ninth Bureau of the People's Liberation Army of China. Another scientist who returned was Yao Tongbin, a world-class metallurgist trained in Germany.

Both Qian and Yao were leading figures in China's missile and rocket programs in the 1950s and 60s, making essential contributions to the Long March rockets between 1967 and 1975. Their work laid the foundation for the later "Project 921" in 1992, the *Shenzhou* (Divine Vessel) I-X, the *Tiangong* (Heavenly Palace) space module, the *Yutu* (Jade Rabbit) lunar lander and the planned Mars probe. When Yao was murdered during the Cultural Revolution, Premier Zhou En-lai was devastated. He knew what this meant for China's scientific quest as many missile failures in the 1970s were attributed to Yao's death.

Yao was only one of numerous such cases. Persecutions of scientists, and intellectuals in general, was ubiquitous during the Cultural Revolution. For example, Bao

Continued on page 43

Continued from page 42

Wenkui was a plant geneticist who trained at Caltech. His experimental schemes were all destroyed by his superiors during the primacy of Lysenkoism in the early 1950s. (Lysenkoism was a political campaign against genetics and science-based agriculture conducted by Trofim Lysenko, the director of the Soviet Union's Lenin All-Union Academy of Agricultural Sciences, his followers and Soviet authorities). Yet Bao persisted with his work, and later developed dwarf rice strains in the 1960s that led to a "green revolution" and helped bring a halt to the devastating famine created by the Great Leap Forward.

Another agricultural scientist, Yuan Longping, was on his way to develop hybrid rice in the 1960s, but his experimental fields were wrecked by the Red Guards, which delayed his research results at a very minimum. His discovery eventually increased rice production yields by 20 percent. Memoirs of other Chinese scientists with similar heart-wrenching experiences during those tumultuous decades reveal an appalling picture of how scientists were treated under one-party rule and the perennial dictates of Communist Party Chairman Mao Zedong. This collective memory has made current Chinese scientists worry about their own future in an uncertain political environment.

Today, China is strong in certain scientific areas, but lags behind in others. Professor Sullivan summarized that China's strength usually lies in theoretical fields such as theoretical physics and chemistry. The number of publications in these areas is astronomical. But in other areas where certain amount of practicality is required, China is weaker. Examples include manufacturing central processing units (CPUs) for computers and jet engines.

Dr. Liu-Sullivan described some promising areas where China can potentially be a world leader: life science and medicine and genomics research. This promising future is epitomized by Dr. Tu Youyou's co-receiving of the Nobel Prize in Medicine in 2015 and the successful establishment of the Beijing Genomics Institute (BGI) since 1999.

China had long coveted the Nobel Prize in science. This wish was finally fulfilled by Dr. Tu. Her main contribution was to discover the most active ingredient of sweet wormwood (*Qing Gao Su*) to treat malaria, a disease that causes high fever and chills, even death in about a quarter of such cases. Tu's discovery has become a standard anti-malaria therapy, and saved more than three million lives in Africa. But akin to chloroquine resistance in the 1960s, resistance to artemisinin has been observed in recent years. DNA sequencing would be helpful in identifying drug resistance

Indeed, on the landscape of next-generation genome sequencing, BGI proudly boasts a shiny spot. The founding President of BGI, Dr. Huaiming Yang, was part of the Chinese team that successfully sequenced one percent of the human genome as part of an international consortium. Now equipped with the world's largest capacity in both sequencing and big data analysis, BGI has not only completed 50,000 human genome sequences, but also substantially lowered the per-genome cost to \$3,000, in stark contrast to \$100,000 from a decade ago. According to Dr. Liu-Sullivan, the future of biotechnology in China will continue to lie in the R&D of niche fields exemplified by herbal medicine and genome sequencing, extending to cloning, stem cell, transgenics and infectious disease research.

## BOOK TALK: STRATEGIES FOR INNOVATION IN CHINA

**George S. Yip**

Professor of Strategy and Co-Director, Centre on China Innovation, China Europe International Business School (CEIBS); Professor of Marketing and Strategy, Imperial College Business School, London

**Bruce McKern**

Visiting Research Fellow, the Saïd Business School, University of Oxford; former Co-Director, Centre on China Innovation, CEIBS

**April 13, 2016**

Having learned the best practices in business from developed economies for over thirty years, does China have anything to offer for the West to learn, as China moves up the ladder from an imitator to an innovator? The answer is a resounding yes, according to George S. Yip, and Bruce McKern. To these professors, China has become a major force to be reckoned with in the global business world. Authors of the recently published *China's Strategic Advantage; From Imitation to Innovation*, they believe China is on course to recapturing its pre-eminent position in technology, which it once had in the 11th century when its exquisite water clocks, equivalent to the iPhones of today, left European countries way behind.

Through a comprehensive study of about 60 large Chinese and Western companies and from extensive interviews and desk research, Yip and McKern revealed

insights into the startling growth of innovation in China. They first defined innovation broadly to include incremental improvements in cost reduction and re-designs of products, processes, applications, supply chains and business models, in addition to the conventional narrower definition of innovation, limited to technological breakthrough. They then synthesized a number of features of the Chinese process from imitation to innovation in different phases.

Chinese companies have greater focus on customers and local needs. Initially, to fit the needs of cost-conscious consumers, Chinese companies copied foreign models as just "good enough" and competed on cost. As the Chinese become more affluent and sophisticated, Chinese companies have upgraded from being a follower of foreign standards to producing and selling at world standards, and are now poised to lead world standards in some areas.

The large scale and diversity of Chinese markets make it worthwhile for companies to serve special needs

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**Chinese companies have upgraded from being a follower of foreign standards to producing and selling at world standards...**

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of some customers by tailoring their products or creating separate categories of goods and services. Large market sizes also make it more affordable for companies to experiment with new ideas. This feature, combined with relatively informal organizational structure and style, permit Chinese companies to have faster and shorter cycles

Continued on page 45

Continued from page 44

of trial and error in product and service development. Chinese companies have thus become very adaptable to local market conditions and newly available technologies.

In terms of management style, Chinese company superiors, often the founders themselves, are more involved in the management of their businesses. When a Chinese boss discovers a problem, he tends to put a large number of staff on it and solve it quickly so that he can win customers' confidence. Chinese employees seem to be used to working harder and longer hours. They have not caught up with the new ethos of "work-life balance" in mature economies.

By being hard working and entrepreneurial for the past decades, Chinese companies have accumulated ample cash and technical capabilities, fulfilling their ambition for overseas expansion. Many of them have expanded globally through foreign acquisitions, initially acquiring foreign companies mostly in the sector of natural resources, now increasingly targeting foreign companies with new knowledge or cutting-edge technology. To further penetrate global markets, some Chinese companies have begun to set up R&D facilities in foreign countries to tap into local knowledge and to be closer to their customers.

In terms of business-government relations, Chinese companies tend to have closer ties to the government, and various levels of Chinese government are more paternalistic. An upside of this particular relationship is that many of the usual chicken-and-egg problems confronting businesses are more likely to be solved in China than in other countries. For example, car manufacturers cannot produce electric cars on any large scale until there are electric chargers as readily available on the road as gas stations. But it's not economically feasible for anyone to

install electric chargers if there is an insufficient number of electric cars running on the road. In such a situation, some heavy-handed government intervention can break this bottleneck. On the other hand, China is weaker at the softer side of management.

Yip concluded that China has a unique advantage of having a combination of a massive manufacturing capacity, a strong science and engineering capacity and an enormous home market. In comparison, India lags behind China on manufacturing capacity, and Japan's home market is not as big as China's.

With this upbeat account of China's business capacity and environment, Yip and McKern anticipated accelerated innovations from China to come to market. They urge western businesses to learn from Chinese companies, specifically their bold experimentation, fast iterations, creative adaptation, rapid new category creation, and sharp focus on lean value. Last but not least, Chinese companies' capability for global outreach is admirable, with many leaders from around the world constituting their mixed management teams. One cliché for business school students to ponder is: "Shanghai, Shanghai, if you can manage there, you can manage anywhere." Yip and McKern's analysis of the success of many Chinese companies offer an essential guide for Western business leaders to benefit from China's growing expertise.

## A HIMALAYAN CONSENSUS: WHAT INDIA AND CHINA COULD DO

### Ambassador Nirupama Rao

Senior Fellow in International and Public Affairs, Brown University; former Foreign Secretary of India; former Ambassador of India to China and the United States

**April 20, 2016**

Whenever the issue of border disputes between India and China is discussed, it has invariably been framed in terms of sovereignty, national security and geopolitics. It has no foreseeable prospect of permanent settlement. Any kind of give-and-take deal-making would be perceived as making concessions, intolerable in a nationalistic environment. In the meantime, the interests of the people in the borderland area are left alone. What can we do about it?

Ambassador Nirupama Rao brought some fresh air into this impasse by offering an alternative paradigm to think about. Having been a Foreign Secretary of India and an Ambassador of India to China and the United States, Rao is uniquely positioned to propose an eye-opening approach to this age-old problem from a humanist point of view. Her approach centers around the interests and the livelihood of the people in the border area—what would be good for them? They want economic prosperity and cultural diversity and vitality in addition to merely maintaining peace and stability at the present time.

Rao delineated India-China relations since the war in 1962 over border disputes. The two neighboring

countries had essentially no contact until India normalized its diplomatic relations with China in 1976. Kocheril Raman Narayanan, the first Indian ambassador to China after the conflict, was called the “normalization ambassador.” When Atal Bihari Vajpayee, the Indian External Affairs Minister, visited Beijing in 1979, China was preoccupied with trying to “give Vietnam a lesson,” in Deng Xiaoping’s words, by waging a Sino-Vietnamese war. Since India was a friend of Vietnam, Vajpayee decided to cut his visit short.

There was a near-military confrontation in the summer of 1986, when some Chinese personnel camped in an area in the eastern sector of the border area, which the Indians considered theirs. If this incident were to happen today, pervasive media coverage would force leaders of both sides to respond strongly with nationalist rhetoric and backed by military force, since “no diplomacy can take place in an amphitheater.” But in a pre-social media era, Indian Prime Minister Rajiv Gandhi still visited China in 1988 against the backlash of this incident. His brave initiative to reach out to the Chinese leadership averted another war. Since then, the issue of territorial disputes, although still unresolved, has not prevented the development of relations between the two countries in other areas, including trade. India’s concern about China-Pakistan collaboration, and China’s concern about the Dalai Lama’s sanctuary in India continue to be points of tension in the relationship.

A solution to the vexed question of the border still eludes the two governments despite several rounds of high-level bilateral discussions. Given this situation, Rao propagated a Himalayan Consensus by which both the

Continued on page 47



Continued from page 46

Indians and the Chinese would work together to promote cross-border trade, transport, cultural exchange, tourism, environmental protection, conservation and development of water resources, and thus address together many challenges pertinent to the border area, such as climate change, environmental sustainability, particularly water usage and biodiversity. In this way, the disputed border area would become a revolving door of people and connectivity instead of a source of tension between the two countries.

Rao recognized challenges in India-China relations. India's economic relations with China are quite skewed with about \$50 billion in trade deficit in 2015. China sells to India manufactured goods such as cellphones and power generation equipment and buys mostly minerals and raw materials from India. The number of Indian students studying in China is many times the number of Chinese students in India, many of whom are trainees in the Indian software industry. It is also evident that China does not seem to pay sufficient attention to India at a higher level of government. When India's Defense Minister visited Beijing this year, he met with the Chinese Prime Minister, Li Keqiang, but not President Xi Jinping. China is, however, sensitive to the development of India-U.S. relations. For instance, the recent visit to India of American Defense Secretary Ashton Carter caught the Chinese attention at a high level, building their case of American "encirclement" of China.

Rao regretted the closed mindset of many people, including a weak receptivity from the Chinese side for building the Himalayan Consensus, for viewing the borderland as a fringe area. To her, it is a sacred space that connects Central Asia to India's northeast and south.

She believed that this land holds a promising future if a political consensus is forged, institutional barriers are removed, and people are allowed and encouraged to come in from all directions instead of being kept out for geopolitical reasons. She depicted a picture of natural organic growth and mutual adjustment by all parties involved in a continuous process of fostering economic and cultural ties. She called for the abandonment of the narrow view of the world in terms of center versus periphery or mainland versus margin.

Rao pointed out that there is a concept of a Euroasian Commons, but the pursuit of the ideal of shared space has not yet spread enough to create a concept of a South Asian Commons. She admitted that there is a question of what South Asia is or consists of. In the organization of the South Asia Association for Regional Cooperation (SAARC), China is an observer only. But it but would certainly object to the participation of the Tibet Autonomous Region, even though Tibet is geographically located in the south of Asia.

Rao wished to look beyond the constraints of nation states and to focus on the interests of the people in the borderland and the surrounding areas. She emphasized the need to connect with this area, enhance its local livelihood, and develop it into a hustling and bustling cosmopolitan area with ethnic and religious diversity and ideological pluralism.

## REPORTING FROM CHINA

### David Barboza

Former Shanghai Bureau Chief, *The New York Times*; winner of the 2013 Pulitzer Prize for international reporting

**April 27, 2016**

In 2013, David Barboza won the Pulitzer Prize for International Reporting “for his striking exposure of corruption at high levels of the Chinese government, including billions in secret wealth owned by relatives of the prime minister.” How did he reveal this explosive story in 2012 with no single source or whistle blower? How did he survive from treading a thin line between personal safety and life threatening danger? In his presentation, Barboza explained his long-term passion for history and journalism since his student years and his decade-long reporting experiences from China, culminating in this earth-shattering coverage of the prime minister’s family’s massive wealth, bringing secrets into the light.

Inspired by books on politics and history such as *Path to Power: The Years of Lyndon Johnson*, *Common Ground* and *A Bright Shining Lie: John Paul Vann and America in Vietnam* as an undergraduate student at Boston University (BU), Barboza wished to become a journalist historian. He began by doing deep research and targeted interviews for his class papers, while forming the habit of keeping detailed notes and organized files. He then tried his hand at the student newspaper at BU. One of his front page stories caused a swirl of controversy and a threatened lawsuit. A silver lining in all this trouble was that it helped launch his internship at *The New York Times* at the age

of 20. He has worked for the publication, off and on, in Boston, New York, Dallas, Chicago and, beginning in 2004, in Shanghai, where he was stationed for 12 years.

A researcher at heart, Barboza travelled extensively throughout China. He visited different kinds of factories, learning how things for everyday use were made and witnessing how hard workers labored under often difficult conditions. He became adept at turning everything into business reporting and turning every business story into a block to paste together for something larger. He observed and wrote about a vast array of topics in more than 600 articles from China, including the experiences of self-made Chinese billionaires and the sudden erection of imposing structures indistinguishable from American signature landmarks. His Shanghai office was lined with large bookshelves and files with clipped papers which constituted his “research institute” that he “carried around” with him. Behind all these books and papers was an alert mind constantly looking for clues for stories, the curiosity to dig deeper, the resourcefulness to improvise strategies along the way, as well as patience and persistence.

As a business reporter, in 2011 Barboza was writing a series of articles on Chinese state capitalism. For the last part of this series, he intended to focus on the Chinese princelings (decendents of senior Communist Party officials). Did they have secret shares of large companies as rumors had it? He began by looking at the nine members of the Politburo Standing Committee of the Communist Party and their children. What did their children do? What positions did they hold? He eventually narrowed his search

Continued on page 49

Continued from page 48

to only one member, Prime Minister Wen Jiabao. He learned that Wen's wife was heavily involved in the diamond industry and his son in private equity. He then studied the shareholding structure of the large Chinese insurance company Ping An, publicly traded in both Hong Kong and Shanghai stock exchanges. He pursued these questions: who were those individuals and companies which owned major shares of Ping An? Who were the ultimate owners of those shell companies? He traced the ownership of those intermediate companies back several layers.

From the officially-stamped documents on these companies, which he obtained by paying a small fee to the State Administration of Industry and Commerce, Barboza

Minister. To establish her identity, he searched the online national database with her ID number by paying a small fee of five RMB. He found that this woman's photo was the same as Wen's mother and that she had changed her name.

With the names of Wen's family members and the ownership structures of all the intermediate companies in hand, Barboza was able to construct an astonishing chart, illustrating who owned what through which company. In the spring of 2012, Bo Xilai, a high-level official in the Politburo and Secretary of the Communist Party in Chongqing, was found guilty of corruption and sentenced to life imprisonment. The Central Government forbade journalists from digging any information on Chinese senior

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**A researcher at heart, Barboza travelled extensively throughout China. He visited different kinds of factories, learning how things for everyday use were made and witnessing how hard workers labored under often difficult conditions. He became adept at turning everything into business reporting and turning every business story into a block to paste together for something larger.**

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was able to delineate a basic story line of a broader picture within a few months. Wen's brother, Wen Jiahong, daughter Wen Ruchun, his son's classmate, Yu Jianming, and the Hong Kong tycoon, Li Ka-shing, were all heavily involved in several of those intermediate shell companies, which in some cases owned large shares of Ping An. Barboza also found that an almost 90-year-old woman bought a large chunk of shares of Ping An just before it went public, and that she was from the same district of Tianjin as the Prime

officials' private assets. In this tightened environment, Barboza flew back to New York to finish his story in the summer. In the fall, he went back to China where he was targeted by the Chinese government. He couldn't even get his emails. To finalize his article, he went to Japan. From Tokyo, he called and interviewed relevant Chinese for his story for the first time. He talked with Wen's family members, various company people involved and Chinese government agencies.

Continued on page 50



Continued from page 49

With his article secured, Barboza flew back to Beijing from Tokyo and met with several more key people - all subjects of his research - to confirm his findings. None of them denied his or her large holdings of all those companies. Some of them only raised a minor issue of valuation of their assets, but this could not change the basic fact that these holdings were astronomical amounts by any measure. They all tried to persuade him not to publish his findings, but in vain.

During his investigation, Barboza kept thinking, "How close can I get to the bottom of this sensitive story? How can I best adapt my strategy to the circumstances?" His entire investigative process relied exclusively on legal means to obtain documents and on extensive study of them without any whistleblowers or any single source. Barboza insisted, "Anyone could have done it." But no one did, except him.



Harvard University Asia Center  
Fairbank Center for Chinese Studies  
1730 Cambridge Street, CGIS South  
Cambridge, MA 02138



