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CHINA'S RISE:
IMPLICATIONS FOR U.S. NATIONAL SECURITY
AND THE DEFENSE BUDGET

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P R O C E E D I N G S

MR. O'HANLON: Well, good morning, everyone. Thank you for coming.

I'm Mike O'Hanlon with Brookings Center on 21st Century Security and Intelligence. I would like to welcome you to an event on China's rise and its implications for American strategy and the U.S. defense budget.

And I'm joined by a very, very capable and accomplished panel that has different elements of expertise on different aspects of the question.

I also see a lot of expertise in the audience. So I have no doubt that once we get to you we'll have some excellent thoughts and questions from you as well.

Our plan for today, after I introduce a little bit more about the subject and my distinguished colleagues here on stage, is to have a little bit a conversation, without formal presentations, but beginning by trying to think through the questions that we've put on the table and then involve you about halfway through as well.

The basic question here that we're trying to get at, of course, is: Where is China's military today? Where is China's military headed in the future? How is China employing its military? More generally, what is China's foreign policy all about?

And then once we get some of those pieces on the table, what does it all mean for us in terms of American policy and American strategy and American defense spending?

And at that latter point I may weigh in a little bit as well as a speaker, but in the first few questions I want to just get through some questions and pose them to my panelists.

Starting next to me, we have Professor Bud Cole of the Naval War, excuse me, the National War College, but his distinguished career was in the U.S. Navy when he was in the Armed Forces of the United States. He retired as a captain after 30

years of service. He was largely, if not exclusively, in the Pacific theater and on surface ships. So he has a great deal of operational experience.

But for a couple of decades now -- it seems it's impossible to put all this into one short career, but he's done it -- he's been an amazing and prolific author on many aspects of China's military, starting with not only its navy but really, more generally, its entire force structure.

So we're going to look to him for a lot of thinking about where is China's military today and where is it headed.

Next to him is my good friend and colleague, Richard Bush, who runs our East Asia Policy Center here at Brookings and, as many of you know, is a longstanding expert on East Asia policy both as a practitioner in the U.S. government -- used to work on Capitol Hill for Congressman Steve Solarz. He then worked in the U.S. government largely on Taiwan issues for many years, and he's been here at Brookings for about 15 years now, working on East Asian security.

He's just one of the most prolific but also one of the most rigorous and careful and thoughtful scholars on the entire region.

So I'm delighted to have him on the panel as well.

And next to him is David Dollar from our John Thornton Center on China Studies, and David is a former U.S. government official who was based in Beijing for a number of years with the U.S. Treasury as our lead economics and finance person there.

Prior to his service in the U.S. government, he worked for the World Bank, including a long stint on and in China with the World Bank as well.

And so he will be particularly helpful in thinking through the question of where is China headed in terms of its economy which, of course, is the foundation for national power, for military capability, for high-technology production of weaponry, and for

the sense that China's rise creates throughout the region and the world of just where is this country headed and to what extent is it potentially rivalling the United States, the broader perception of China's power and what that does to the diplomatic aspects as well as the military and economic aspects of the region and how all these things fit together.

So, without further ado, what I'd like to do then is walk through a couple of these questions, one by one, beginning with Dr. Cole and asking him just for a few minutes of thought on how you see China's military today.

I'll just add, as I think many of you know, China's military budget, even though it's not denominated in dollars, is estimated at being the equivalent of roughly \$150 billion a year plus or minus, let's say, 25 to 50 percent depending on who you're talking to and which methodology you're employing, and that almost regardless of where in that range it might actually be most properly located, it's easily the world's number two military power behind the United States now by spending.

We are certainly in now -- if all of power were about just spending levels, we'd be in no imminent danger of losing our position because the United States is still spending some 550 to 600 billion dollars a year, 3 to 4 times China's amount.

But, of course, much of what we're thinking about is how this all comes together in the Western Pacific theater, specifically, which is China's main focus of its military activities and only one of ours.

And so it's a little more complicated than just comparing defense budget levels.

So, with that as prelude, Dr. Cole, thank you for being here. I'd just love your sense of how you see China's military condition, position, capability today, and where you think it's headed in the coming years.

DR. COLE: Well, thanks very much. I'm delighted to be here this

morning, especially to see such a large turnout.

The way I usually characterize China's military modernization, which has certainly been significant over the last quarter-century, is that they're improving at a moderate pace. I don't see any big crash program going on with the People's Liberation Army.

Having said that, as Mike said, where the U.S. military responsibilities are global in nature, China, so far, has been able to focus primarily on the Western Pacific and on Asia. And what we have seen in a significant shift is away from the historic Chinese concern about threats from mainland Asia to now being able to focus on the maritime realm off the coast to the east and, to a certain extent, to the southeast.

One of the remarkable things about Chinese diplomacy in the last quarter-century or so is the way they have resolved their border disputes with everybody except India, really. The land border with Vietnam is still a little bit iffy perhaps, but it's formally been resolved.

And so I think that what has happened in the Chinese military, most significantly in the last, oh, four or five years, is a shift in emphasis from the army being the chief beneficiary of budget increases to the navy, air force and second artillery -- that is, the Chinese missile forces -- receiving the most emphasis in the budget councils.

This is a little bit of an interesting situation because if we look at the command and control of the People's Liberation Army it's still very much centered on the army whereas most of the budget emphasis seems to be shifting to the other services. I think this indicates a shift in the national attention and concern to not only the maritime element but also the ability to maintain a certain minimum level of nuclear deterrence.

MR. O'HANLON: And if I could ask you how you see their capabilities today relative to what you might have predicted for 2015, if I'd asked you the same

question in 2005.

I think one of the big questions -- and it obviously affects perception -- is not only how fast are they improving and how good they are today but how does this compare with expectations because the up or down on that is, as much as anything, what shapes people's perceptions.

So how would you compare where they are today to what you might have predicted 5 or 10 years ago?

DR. COLE: I don't think we should be surprised by what we see in China. The large military budget increases come not so much, in my view, from a shift in emphasis of national spending from other sectors to the military but rather simply from the fact that the Chinese economy has been expanding so impressively that there's simply more money available to devote to the military. It's within the military that I think we've seen some resource allocation changes.

If we look back in history at the rise of various other great powers, I think we should expect China to be devoting more and more resources to a modern military, in this case, a 21st Century capable military.

MR. O'HANLON: Now when Admiral Willard was the head of Pacific Command, he made a statement in, I think, about 2009, in which he said that China's improvement in its military has exceeded our expectations almost in every category.

It sounds like you're a little more restrained than that assessment. Am I reading that correctly?

DR. COLE: In general terms, yes. I'm sure if we looked at specific systems or specific capabilities, for instance, I'm a little bit surprised at how efficiently they've progressed, apparently, in the area of cruise missiles, but in general terms I don't think I would sign up to what Admiral Willard said.

MR. O'HANLON: One last question and then I'll go to Richard, which is, of course, as you well know, the estimate is that whatever China's actual military spending level might be, most people seem to agree that it's about 2 percent of their gross domestic product.

And David may want to comment on this later as well.

Do you agree with that number?

And then secondly, do you see that as maybe reinforcing your argument that we should interpret their buildup as gradual because 2 percent is less than ours -- we're at 3.5 percent still -- and it's not a particularly big number by historical standards for great powers?

DR. COLE: Well, the number game is too hard for me to play, frankly. Even if we knew the accurate figures coming out of China on defense spending, which we don't, I don't think, again, I think that they're still spending at a relatively moderate rate.

And I think they're doing that deliberately because they're focusing not only trying to match the U.S., for instance, missile for missile or ship for ship or tank for tank, but rather they're focusing, I think, on specific strategic situations -- Taiwan, for instance, as well as the East China Sea, South China Sea, and other topics we'll probably get into here.

MR. O'HANLON: Okay. So we'll come back to that in a little bit.

Richard, please, we'd love your thoughts on any of what we've been discussing already but especially on the question of how you see China's behavior in recent years and what we should, therefore, be taking stock of ourselves as we think about American policy.

MR. BUSH: Thank you very much.

And I agree with everything that Bud has said.

Let me comment a little bit on military budget.

I think specialists believe, first of all, that gradually things that have been off-budget or not publically announced are going on-budget.

Second, the PLA was for many, many years starved of resources because the regime did not have the resources to give to it, and so a lot of this is catch-up, particularly in the area of pay.

Third, although we talk about double-digit growth, the real growth rate has declined. The best estimate I've seen is from about 11.4 percent in 2003 to 8.3 percent in 2012. The defense budget as a share of GDP in real prices has, interestingly, stayed in a range of 1.28 percent to 1.45 percent over the last decade. And, finally, the share of the military budget as a share of state expenditures has declined.

Now, the -- what's important for the United States is how these resources are used and what's the effect on our national security interest, and again, I think some context is important.

First of all, we have to recognize objectively that for decades a militarily weak China lived in a state of fairly profound insecurity. The United States was there on its doorstep. We fought a war in Korea. We almost fought in Vietnam. And I think the primary and underlying goal of current defense policy is to reduce the insecurity.

Not all of China's fears are well-founded. There's an intention -- there's a tendency to misread the intentions of adversaries. There's a tendency to want the other guy to make all the concessions. But the fears have enough of a basis in reality to compel responses, and I think that's what we're seeing.

I agree with Bud that the primary motivation and focus of China's military buildup since the late 1990s was Taiwan and dealing with what they perceived as the

threat of separatism, Taiwan independence, and that has given a focus to what they've done. Of course, military capabilities are dual-use, and what you can use for Taiwan you can use for other purposes.

I think there is a strategic -- larger strategic focus to what China is doing, and that is to create more of a strategic perimeter, more strategic depth. China, for many years, had to think about defending against the United States at the coast. That's a terrible place to have to defend your country.

And so if I were a Chinese defense planner, I would want to be doing exactly what they're doing. The problem is, of course, that space is already occupied. We're there. Japan is there. There are Southeast Asian countries there.

And that's the reason that we will -- we have frictions with China and we will continue to have them.

Then you have natural resource competition as well.

Now I don't -- the current worry on everybody's mind, of course, is what's happening in maritime East Asia. And as China's military capabilities and law enforcement capabilities have grown, it has grown somewhat more aggressive in its actions in the maritime domain, putting Japan on the defensive around the Senkaku Islands and establishing its presence and strengthening its presence in the various land forms in the South China Sea.

My own view is that conflict is not inevitable. How you respond to each little move on China's part is not easy, but there are other ways to deal with these problems. There is diplomacy, and what we've seen in the last six months, I think, is a shift away from more coercive actions to more diplomatic ones, including talk about some kind of CBM regime around the Senkaku Islands, talk about a binding code of conduct in the South China Sea.

I think China has realized that its recent behavior has created a great deal of anxiety among its neighbors; that's not in China's interest. It's not in China's interest to take on the United States at this point in its development. And so they're backing off.

How long this will last? Nobody knows, but you know, it is possible that it will last and that the military will be kept in the background as a tool of national power.

MR. O'HANLON: If I could follow up with a couple of other questions before I go on to David.

One, because we're going to talk about U.S. policy in the second round of questions and thoughts from all of you, I'm just trying to establish a good military baseline. And you both contributed already to understanding that, but you both talked about improved capabilities.

Could you give us a little bit of a vivid sense of some new capability that China has now that it didn't have before in strategic terms?

So Bud mentioned missile capability, much more precise, much more numerous. But what does that mean, say, for China? To what extent could China more effectively threaten Taiwan than it might have 10 or 15 years ago, if you see a qualitative change that's important strategically?

MR. BUSH: Well, Taiwan is a place where we have seen a change, and China's development of long-range precision strike capabilities, particularly ballistic missiles but also cruise missiles and more advanced fighter aircrafts, has changed the military calculus across the Taiwan Strait. It has created a much more formidable deterrent against any effort to separatism.

Moreover, I think the improvement of China's air and naval capabilities is such that some experts at least believe that it would be difficult for Taiwan to defend itself

with what I think was the traditional strategy of trying to establish air and sea control over the Taiwan Strait. That would be the preferable strategy, but that may not be possible anymore because of the PLA's growing capabilities.

MR. O'HANLON: Just one more thing, if I could, on this before going to David and thinking about China's underlying economic strength and power.

You gave a somewhat fair-minded, as is characteristic for you, a fair-minded interpretation of why China is building up a military, but I know you also probably have concerns about certain aspects of their behavior, and you've hinted at a couple of those.

But if I could ask you, since we're thinking about what this might mean for U.S. strategy and the U.S. defense budget and so forth, are there any particular areas of Chinese behavior that you wish had been different or are particularly concerned about or trend lines that you think we might have to factor in specifically as we anticipate where American strategy may have to go?

MR. BUSH: Well, the one I worry about the most right now -- and I don't worry as much today as I did maybe eight months ago -- is the way in which China rather coercively promotes its claims both in the East China Sea and the South China Sea. It's not that I fear that China is going to take the Senkaku Islands because once you take them they're damn hard to hold and I think Japan's self-defense forces would do a good job in defending them.

What I worry about more is a modest clash between the law enforcement capabilities of the two countries that then spins out of control because of bad crisis management, because of domestic nationalism, and so something that shouldn't have happened and shouldn't have been a big deal then becomes a big deal and we become involved.

MR. O'HANLON: So on that point and last question, I promise, but just to clarify that, I think it's important to make this vivid as we think about where American policy may have to respond.

You referred to the confidence-building measures, the CBMs that President Obama and President Xi worked on in November in their summit, for example.

My understanding -- I just want to check with both of you on this point to make sure we get this clear and make sure I'm understanding it correctly. As welcome as that is, nonetheless, it applies to the United States and China, not necessarily Japan.

MR. BUSH: Mm-hmm.

MR. O'HANLON: And also it applies to navies, not necessarily coast guards or the equivalent.

MR. BUSH: Mm-hmm.

MR. O'HANLON: And those are really the instruments that have been most involved --

MR. BUSH: Yes.

MR. O'HANLON: -- in the Senkakus.

MR. BUSH: That's right.

MR. O'HANLON: So do you see those same limitations, both of you?

DR. COLE: I think that China has a very poor record of calculating what a U.S. response would be, whether it be one of the Taiwan Strait crises going back to 1950 or what's going on in the South China Sea and the East China Sea.

And I worry that the Chinese military, or maybe even the National Command Authority in Beijing, believes they have the ability to contain or prevent unintended escalation of a military conflict, a military clash, whether it be with the United States or Japan. I think that should be a major concern.

MR. BUSH: I agree with that.

There have been discussions very recently between China and Japan on various kinds of measures to reduce the risk of a situation in the Senkakus, and those, as I understand it, will include coast guards. It's still very much a work in progress, certainly for us but especially for Japan and China, but drawing in China to this kind of discussion is a really good thing.

MR. O'HANLON: So, David, I think we're all curious about where China is headed as well.

And we all know that whatever it might want to do with its military budget it's the economy that ultimately provides the foundation not only for the size of the budget but for the high-technology capacity of its armed forces and weaponry modernization.

And then, of course, it's the progress in the Chinese economy that largely shapes the perception in the region and the world of whether China is the rising superpower and America is perhaps in decline, relatively speaking, or whether this is something that's going to level off.

So we just welcome your thoughts on the strength of China's economy and where you think it's headed.

MR. DOLLAR: Okay. Thanks.

First, it's a great pleasure to be here, be the economist listening to this interesting discussion.

You probably saw the announcement earlier this year from the IMF that in purchasing power parity terms China has already passed the United States as the biggest economy in the world. And that purchasing power parity calculation is essential if you want to compare living standards across countries.

But if you're talking about weight in the world economy, I would argue

that you want to measure the economy at market exchange rates. Trade and investment actually take place at market exchange rates. And, on that basis, the U.S. economy right now is about 70 percent bigger than the Chinese economy.

Right now, the numbers are relatively simple. Chinese economy is about \$10 trillion; U.S. economy is \$17 trillion. So U.S. is about 70 percent bigger.

Now that gap will certainly narrow in the near future. China's growth is slowing down. It's not going to be 10 percent in real terms as it's been, but I think most analysts accept that if China follows through on reform it has the potential to continue to grow at 6 or 7 percent until about 2030.

A lot of uncertainty. There certainly are downside scenarios.

There's also up and downside scenarios for the U.S. You know, many people think the U.S.'s sustainable growth rate is now about 2 percent real.

I'm a little bit more optimistic. I think if the U.S. follows through on its own reform agenda, the U.S. has the potential to grow at about 3 percent in real terms.

But what all that adds up to is -- most likely scenario is that by 2030 China will be about the same size -- China's economy will be about the same size as the U.S. economy in 2030. So I think that's a useful way to think about the near future.

Now some people extrapolate the high growth rate further and argue that after a few decades China will be several times bigger than the U.S. economy.

Personally, I think that's very unlikely. I think there are a number of reasons why China's economy is likely to slow down after 2030 even if it's doing well.

It's got a lot of challenges, and let me just emphasize one. It's got very severe demographic challenges. So the working-age population has already peaked in China and started to decline.

The urban labor force will keep growing for a while because of migration;

that's why China can continue to grow well. But after 2030, the population is going to start declining; the labor force is going to decline very sharply. Between 2030 and 2050, the labor force is projected to decline by 120 million people. So it's quite difficult to continue to grow well when your labor force is shrinking.

All economies need to be adjusting all the time. It's easier if your labor force is growing. The United States is the only advanced economy where the labor force will continue to grow at a healthy rate throughout the century, primarily because of immigration.

So, after about 2030, it's not obvious to me that the Chinese economy would be growing faster than the U.S. economy.

You know, a lot of uncertainties. A lot depends on what each of these countries, these societies, do. But I think looking out further, just as likely the U.S. economy will emerge as the biggest economy in the world later in the century. I think that's just as likely as China being the largest economy later in the century.

MR. O'HANLON: That's quite a remarkable prognostication or at least possibility.

MR. DOLLAR: I emphasize a lot of uncertainties.

MR. O'HANLON: Right.

MR. DOLLAR: So we're talking about scenarios here.

MR. O'HANLON: By the way, I want to say -- and I'm sure Richard remembers, too -- it's nice to be on a panel with you again. The last time I was on a panel with you was in Taiwan except you weren't there because you had had knee surgery. So Richard had you do a VTC, and you were about 30 feet high in the room. But even when you're not 30 feet high, your ideas seem like they are.

So, anyway, thank you for that crisp explanation.

What I'd like to do now is really just go down the row and ask the second main question. This one is simpler, and it's the same for all of you, which really is to get the conversation started, the conversation that I know we're going to have with all of you in a few minutes as well.

What should the United States do about the current situation that we see in China?

And you've all laid out a number of aspects -- military modernization, foreign policy behavior, economic future, prospects for China's long-term growth.

What does this mean about the near-term American response?

And as you all know, the Congress and the President here on this side of the Pacific are going to have to cope with the question of do we tolerate the possibility of the defense budget either being sequestered or held to the sequestration levels, which is looming again for fiscal year 2016. 2016 is now only 9 months away in fiscal terms.

And regardless of whether we go to sequester or not, we're going to still be three times as well-endowed in our military budget as the Chinese. But the trend lines are getting interesting, and you can now sort of see these two countries' military budgets on the same graph in a way that wasn't so evident before.

And, as David said, if people extrapolate far enough out, they can make interesting things happen with lines crossing with the defense budget maybe even sooner than with GDP, depending on who spends more.

Now right now, we're spending more than 3 percent of GDP.

Richard and David have pointed out, Richard particularly, maybe it's more like 1.5 percent in China.

If you do the math on the number I gave before, 150 billion divided by the 10 trillion economy, that's also 1.5 percent.

So it's much less than ours, but if China's budget were to grow as a percentage of GDP and ours continues to decline, these curves could begin to converge to some extent.

And so the question I really want to ask all of you is: What, if anything, should we do about it in the U.S. defense budget context in the short term?

Maybe I'll begin with you, David.

MR. DOLLAR: Can I go first because I have the bland answer?

MR. O'HANLON: Yes, I think you should.

MR. DOLLAR: So I'm not a military strategic kind of person at all, but just thinking intuitively, the most important issue for the U.S. in order to be a leading force in the world is to maintain U.S. share of global GDP.

There are a lot of reasons why developing countries are growing faster than rich countries.

So the U.S. share has a tendency to decline, but that can be very slow.

So I just want to make the point that whether the U.S. grows at 2 percent or 3 percent may sound like a small difference, but as you're looking out toward 2030, 2050, it makes a huge difference. Right.

So just briefly, things like investing in infrastructure, strengthening education, and then immigration is a key factor in U.S. growth. And we could reform our immigration policy to make it more rationale so that all these smart students who come to the U.S. from around the world -- we should make it easy for these people to stay if they want and be entrepreneurs and be productive people.

So we can influence our economic growth rate fairly significantly, and out 20, 30 years, it's going to make a huge difference whether the U.S. grows at 2 percent or 3 percent.

MR. O'HANLON: So if I could link that -- before going to Richard and then Bud, if I could link that to the U.S. defense debate, but also the U.S. budget debate more generally that we're having now, it sounds like you're not all that super worried about whether U.S. military budgets for 2016 are going to be -- you know, leaving aside the war supplemental -- are going to be 500 billion or 550 billion.

You might be equally concerned about whether we sequester the domestic investment accounts that you talked about as important for our long-term future.

MR. DOLLAR: Yeah, just briefly, if there's some kind of -- the U.S. has got its short-term fiscal situation in good shape. So we can afford to spend modestly more money.

And as I said, I'm not a security person, but if the compromise is to spend more money on infrastructure, education and defense within a sustainable fiscal framework, that would be a good compromise.

MR. O'HANLON: I'll say for those of you who aren't following this in great detail that, as you all know, this is budget week. It's the Friday of budget week, and the President put out his budget on Monday, and he alluded to it in the State of the Union Address earlier.

As I think many of you know, what he's trying to do is to increase spending on both domestic and defense discretionary accounts, about 35 billion each, 35 to 40 billion each, relative to what that Budget Control Act and the sequestration level would require if we can't get around that, you know, existing law. So he's trying to do what you're suggesting, but of course, the controversy comes in as to how do you pay for it.

And, with defense, you always have a safety valve, which is you can put more things into the war supplemental and they're not subject to the other caps, and you

can play that game to some extent. With non-defense, you don't really have that safety valve. So it remains to be seen if the President and Congress can agree on a way to pay for these investments that you're calling for.

Richard, over to you, and we'd just love your thoughts on how you feel the U.S. defense debate should reflect all these concerns.

MR. BUSH: Excuse me. Let me start with the pivot. And I actually think that the pivot really isn't a new policy; it's an adaptation of a very old policy to new circumstances.

And I think our policy towards Asia has been based for decades on an active military, economic, diplomatic and political presence in the region so that we set the context in which our friends, allies and potential adversaries make their national defense decisions and decide what risks they want to take.

We have been, in a way, the cop on the beat that creates peace in the neighborhood. It's very important for us in the region that we continue to be able to do that.

And so I see sequestration on defense as a critical challenge, and there seems to be a growing consensus with the President and Republicans on the Hill that we need to find some way around it. Experience over the last four years does not make me terribly optimistic that we can get to the goal that we want to achieve.

I agree very much with David that we need to strengthen these pillars of national power that allowed us to emerge in the 20th Century as a force for peace and stability and prosperity around the world.

Within East Asia, I think the most difficult challenge is calibrating our responses to Chinese moves in the East China Sea and the South China Sea so that -- in a way that encourages restraint on China's part and doesn't feel that they can constantly

nibble away at the current status quo.

We may have a bit of a challenge coming up because Taiwan is having an election about this time next year, and that may bring about some changes at least in how China perceives the situation.

But I think, in summary, that we have the capacity to continue to play the kind of role that we have played in the past, and that would be a good thing. Whether we have the will to do so and the political system to express that will is another question.

MR. O'HANLON: So to clarify one thing in my understanding -- thank you. That was very well-stated, but I want to make sure I understand what I think was one of your messages, which is if sequestration were to occur, and you're against it as I heard you just say, but if it were to occur, your greater concern might be the signal that it would send about our inability to function effectively as a government and carry out policies that we'd already decided and promised to effect, and maybe less so -- again, I'm trying to be provocative to clarify -- and maybe less so what it actually means for specific military programs but more for the sense of our leadership.

MR. BUSH: Sorry I wasn't clear. I mean, it's very important what the signal is, and it's certainly that both to our friends and allies but also to China because that changes the risk calculation of all of them.

But I do think that sequestration, if it were continued over an extended period of time, the rest of the whole 10 years, it would have an important impact on our ability to continue the policy of forward deployment, which really is the basis of peace and security in the region.

Sometimes our friends in Asia complain that the President of the United States has not shown up at a major meeting, and I understand that.

I think it's far more important that the aircraft carrier battle group show

up. And if we can't do that, then we're living in a very different world.

MR. O'HANLON: Thank you.

Bud, over to you. I'd just be curious for your take on where you think U.S. defense strategy and budget have to go in these next few years.

DR. COLE: Well, to expand on something Richard just said, a recent Chief of Naval Operations said that if sequestration takes full effect that the U.S. Navy will no longer be able to maintain the constant presence and the constant series of six to nine-month deployments that we've followed since roughly, I suppose, the Korean War, but instead, that the battle groups, those carriers, would be home ported in the United States, possibly Hawaii, one on the coast of Japan, and would only be able to steam out in times of crisis, which of course changes the whole timeline and the whole paradigm of how you respond to a crisis.

I think that the most likely areas -- and I'm stealing a page here from something Ambassador Stapleton Roy and I talked about several years ago. The area of most concern right now and for the foreseeable future is the three seas -- the Yellow Sea, East China Sea and South China Sea. These are areas that I've become convinced Beijing believes are vital national interest areas to China.

And of course, the other side to that coin is we have defense treaties with South Korea, Japan and the Philippines, and we have a special relationship with Taiwan and with Singapore, and of course, we have the treaty with Australia.

So this is the area, it seems to me, of most likely conflict, and this is the area where, hopefully, we can use diplomacy instead of aircraft carriers to resolve our differences.

I think China, to a certain extent, is playing a risky game, particularly in the South China Sea. And that is when I talk to counterparts out in the U.S. military who

are stationed in the Pacific, they wonder where the threshold is. In other words, what would it take China to do, say in the South China Sea, to evoke a U.S. military response?

I don't know where that threshold is. I'm not sure anybody in this city does. But it's a relatively dangerous situation, and I think it goes back to what I said earlier about Beijing's historic inability to accurately calculate the U.S. response to Pacific crisis situations.

Let me talk just for a minute, though, about a difference, I think, in Chinese behavior in the East and South China Seas.

It seems to me in the East China Sea, given the nature of the U.S. commitment to maintaining Japan's claim to the Senkakus, which is not one of sovereignty but one of administrative control, that China is trying to demonstrate that that administrative control by Tokyo does not, in fact, exist on a day-to-day basis.

But in the South China Sea, on the other hand, given the multiplicity of claimants, I think China is simply moving ahead, building artificial islands, simply using military power as they did against the Philippines.

I suppose there's a benefit to using white-hulled ships -- that is, coast guard -- instead of People's Liberation Army navy ships, but the end result is the same. It's using armed force to enforce your claims.

And in the case of the Philippines, it's simply because the Philippines can't object to it at sea.

As far as U.S. future strategy is concerned, I think our strategy has remained fairly consistent although I'd argue that the U.S. military strategy has not been clearly delineated particularly well since perhaps 1986, when the navy came out with the Maritime Strategy.

I think that's understandable. It's hard to generate a meaningful military

strategy when you don't have a very specific, single opponent in mind.

It was easy to define a military strategy against Japan in the 20s and 30s. It was easy to define a military strategy against the Soviet Union in the Cold War. It's not easy to do that now.

What the U.S. military is facing right now in the post-Iraq and Afghanistan years is defining the ends, I think, that they want and what means they need to reach those ends. It's not an easy solution, and in the era of declining budgets, not to mention possible full sequestration, it's a difficult problem to solve.

MR. O'HANLON: So let me ask one last question about the South China Sea that you mentioned in your answer, which is something Michael McDevitt and others here have thought about a great deal. And so I know that we're going to have a lot of participation very soon on this and other questions, but this is a good place, I think, to bring it all together as we wrap up this phase of the event.

What's the U.S. role in the South China Sea? Because you've all talked about -- especially Richard and Bud, you've talked about U.S. presence being important.

You haven't talked about -- and I think you probably don't hope for -- a direct U.S.-China conflict. You're not necessarily gauging the U.S. military in terms of how do we make sure we can win the all-out war. Maybe that's a consideration, but it doesn't sound like it's your main consideration.

How do we think about the U.S. role in the South China Sea? What is our military and our diplomacy trying to do there, just you know, in terms that we can latch onto here as we have the rest of the conversation?

DR. COLE: Well, we do have a defense treaty with the Philippines, but since the defense treaty was signed before the Philippines laid claim to some of the islands in the South China Sea, some of the Spratly Islands, I don't believe the U.S.

government has ever forthrightly said that we agree with the Philippines' sovereignty claim to those islands.

One could question, frankly, why in 2015 we need a mutual defense treaty with the Philippines since the Cold War is long over. So we've been playing a very careful diplomatic game, I think, in the South China Sea.

U.S. policy, as I understand it, is very straightforward. We don't back any nation's claims to sovereignty over the land features in the South China Sea. We urge everybody to resolve their differences peacefully, but we will not stand by and accept any attempts by any of the claimants to interfere with freedom of navigation by U.S. or other ships through the South China Sea.

And so the danger is the well-known 9-dash line that China has published beginning possibly as early as 1922. Beijing has never really defined what they mean by that. They keep saying that they claim the land features and associated waters. If we were getting into the United Nations' Convention on the Law of the Sea, just defining associated waters could take the rest of the day. So there's a lot of uncertainty with respect to that.

I think the bottom line U.S. concern in the South China Sea is that there would be no constraints imposed on the freedom of ships transiting those vital sea lanes.

MR. O'HANLON: Richard?

MR. BUSH: I agree with all of that.

I would only add that China's ability to incrementally improve its presence in the landforms of the South China Sea can have an important psychological effect on how the United States is perceived and how our friends and allies assess our resolve, but it's really hard to figure out exactly what you want to do as each little action takes place.

MR. O'HANLON: David, any thoughts on -- why don't we open it up to

you?

MR. DOLLAR: Just happy to listen to that.

MR. O'HANLON: Well, thank you very much, everyone. I think we have a lot on the table and a lot of thoughts and expertise among you. So let me please ask you, once the microphone comes to you, to state your name clearly and pose a question.

I'm going to take two at a time to start.

And if you can direct your question primarily to one person, I'd prefer it. If it doesn't work out that way, that's fine, too, but if you have any ability.

Why don't we start up here in the front with these two gentlemen for round one?

QUESTION: Thank you all very much, but it seems that --

MR. O'HANLON: Please identify yourself.

QUESTION: Oh, sorry. Michael Yahuda, formerly from the London School of Economics and now with George Washington University.

It seems to me that there are two elements in what we've heard. One is that there is somehow quite lot of continuity in U.S.-China relations and also in terms of China's sort of emergence and continuing emergence as a military power.

But I think one element that is -- that constitutes a major change, especially for the United States is the relationship, or combining the relationship, with China with the relationship with allies in ways that haven't happened before in the sense that China's immediate challenge is not directed at the United States; it's directed in its neighborhood. And, indeed, its leader has articulated a vision of an Asian order in which it's very difficult to see where America fits in from that point of view.

So for the United States, obviously, the main thrust in its approaches to East Asian centers on China, but the challenges are going to be much more in terms of

relations with allies.

So, in one sense, the United States has to demonstrate to its allies and partners that the United States has sufficient resolve, sufficient capabilities, to deal with the threats that exist to them as far as they perceive them.

On the other hand, the United States does not want them to be "provocative" regarding China. And what is provocative, of course, depends very much on perceptions and so on.

In this sense, it seems to me that the United States is facing a kind of diplomatic challenge which it has not had before, and this is going to create all kinds of different difficulties.

One is to what extent can the United States coordinate all the different elements of its policies, as Richard Bush indicated. There's the economic. There's the political. There's the military, and so on and so forth.

So to what extent do you think we are here beginning to think creatively as to how to deal with this challenge?

MR. O'HANLON: Thank you.

And here in the front row, please.

QUESTION: My name is Arnold Zeitlin. I've been teaching in China, and I think maybe David might be the first one to respond to my question.

I'm wondering if it's possible to compare U.S. and China military spending on a PPP basis insomuch as costs in China in some sectors are much less.

MR. O'HANLON: David, do you want to start and then we'll have comments from Richard?

MR. DOLLAR: Yeah, I was afraid someone would ask this question. Okay. So I'm not an expert on the Chinese military budget but listening to them.

Since when you make the general PPP correction, right, you're basically raising China's GDP by about -- by more than 50 percent. Actually, by 78 percent would be the current estimate.

So one initial thought would be take that \$150 billion rough estimate of Chinese military spending at market exchange rates and just raise that by 70 percent. It would, of course, be the same share of GDP, right, but it would be 70 percent higher.

Now I think in terms of thinking about the soldiers that probably makes sense. You know, if you can hire an equivalent soldier in China for a lot less than in the United States, then it makes sense to do that price correction.

But if you look in the details of the PPP calculation, prices of advanced machinery tend to be the same in the two economies. Right.

So I don't know how much of the Chinese military budget goes to equipment versus pay for soldiers, but if a lot of the budget is going to equipment, then it would be a mistake to make the PPP correction. Right.

Basically, the price of an equivalent quality piece of weaponry may very well be similar in China as in the United States. That's what you would find for advanced equipment in the non-military sector. So, you know.

So probably the answer is you wouldn't want to make the full 70 percent adjustment, but in thinking in real terms you'd want to make some adjustment.

MR. O'HANLON: Thank you.

MR. BUSH: If I could speak to Michael's question -- it's a very good question -- my response would be that this is not a completely new problem; it's a new version of an old problem because we have had to reassure our allies about our resolve ever since those alliances were created. We have had to worry about independent action by our allies.

For example, I think one purpose of the U.S. mutual defense treaty with South Korea was to make sure that South Korea didn't go north. That's not a concern today, but it was a concern earlier on.

Similarly, our mutual defense treaty with the Republic of China -- you know. There were understandings at the time that if the Republic of China was considering any action against the mainland, any major action, it would have to get our prior approval, and there was a series of incidents where there was a lot of argument over what's a major initiative and what's not.

I think what makes this more complicated today, obviously, is China's greater power and its greater ability to expand its power and influence in the region, which is the first and principal area of competition.

Moreover, another new development is nationalism in all the countries concerned, which greatly complicates how national leaders, including in China, assess threats to their national security and respond to those perceived threats.

MR. O'HANLON: You want to have a go at any of that or should we...?

DR. COLE: No, I'd like to.

I think that Professor Yahuda has really struck a main chord here. The folks like me who tend to concentrate on the Chinese military have to constantly remind ourselves that the Sino-American relationship is much broader than that and that the economic and diplomatic relationship, particularly the economic relationship, is extremely important.

Several years ago, when Admiral Mike Mullen was the Chairman of the Joint Chiefs of Staff, he called a bunch of folks together and said we need to get away from strictly looking at a military relationship and try to look at the broader scope, a whole-of-government approach to how even JCS or the Pentagon deals with Chinese

counterparts. I'm not aware, frankly, that much has come of that, but that was his idea.

Of course, he was also the chairman who said that the most important national security problem in this country was economics, not some sort of military balance.

I also note that the overall strategic situation is based on geography. I mean, geography rarely changes very much. We can come up with some instances of it, like the Yellow River shifting course in, I think, the 18th Century or something. But geography matters, and if you're sitting in Singapore or Seoul or Tokyo or Taipei, you have to pay attention to that.

And I once suggested to the Deputy Minister of Defense from South Korea that perhaps before the end of this century that a trade would be made. South Korea would give up the mutual defense alliance with the United States to emerge as the governing body of the entire peninsula. I didn't get a response.

But thinking very long-range, I think those sorts of thoughts need to be considered at some point.

MR. O'HANLON: I'm just going to toss in one thought on this question as well if I could on the U.S.-Korea relationship. As many here in the room remember and, in some cases, know much better than I, in the mid-2000s the Bush administration asked Seoul for what they defined as strategic flexibility.

And I'll be a little bit simplistic at the risk of being over-simplistic. What we meant by that was we would like to have, to some extent, advance permission to be able to use the forces normally based in Korea for other contingencies in the region.

And as we all know, the relationship between President Roh and some parts of the Bush administration wasn't so strong in this period.

And President Roh, even though I was not a big fan overall of his tenure

in South Korea, but he had a very reasonable response.

He said, "You mean you want to be able to use forces in Korea about the Taiwan problem or some other area of East Asia? I gotta live here with the Chinese for the rest of eternity, and I would rather have some say.

"Obviously, if you want to take your forces, move them somewhere else, and then use them there, that's your prerogative. But if you want to use my country as a staging base for continual air combat operations, maybe I should have a say when the actual crisis occurs."

At which point, the Bush administration, I think, essentially stood down the request, which I think was the right way to go. And they probably shouldn't have asked in the first place, frankly.

And then one other point on Korea, Jim Steinberg and I did a book on U.S.-China relations last year, and we spent a lot of time on Korea -- and I know others, again, in this room have, too -- thinking about a possible Korea contingency. And a lot of our focus was on how the United States and ROK might want to work with China to involve China in managing that kind of a crisis rather than just sort of assuming China would stay out or assuming that China should stay out.

And this was an area where we thought for a number of reasons, including those that you were getting at, a collaboration, even though it would have some risks of its own, would be more prudent than trying to keep China at arm's length.

Anyway, enough on that.

We've got a couple of friends over here. Why don't we take these two?

Either way.

Mike.

QUESTION: Hi. Mike McDevitt.

Earlier, Michael, you asked the question about what about China's focus on military development is a surprise to you.

There is one surprise, at least for me. Over the last 18 months, 2 years, China has announced the avowed goal to become a maritime power and a maritime power that's not just a navy. But it is the navy. It is the coast guard. It's their shipbuilding. It's their merchant marine. It's their fishing industry. It's their ports, et cetera. The infrastructure. It's an elaborate vision.

And I've been looking into that, and I guess a related surprise is in terms of the navy. For the strategy that has been discussed -- essentially, keeping the United States away from the coast of China -- the navy only needed submarines, and then, of course, the rest of the PLA had missiles and airplanes to deal with that.

What we see happening now is the surface ship part of the Chinese navy is growing -- growing to the point where by my calculations, in five or six years, China is going to have the second most powerful, balanced navy in the world. And so they're going to be a global maritime power with a global navy, and that's very different than just a regional force.

I'm not -- this is not particularly sinister or scary to me. It's just interesting. It's something that I had never anticipated -- them going beyond a regional focus.

MR. O'HANLON: Thank you.

We'll want to get into some possible explanations of that when we get up to the panel but, please, first.

QUESTION: Thanks. Alan Romberg, Stimson Center.

It's a great panel. Thank you very much.

I guess my question in the first instance goes to Richard, and that also

has a strategic vision dimension to it.

Perhaps also overly simplistically, I would say that one reason China has behaved as assertively as it has in the region in recent years is because it can, and that goes largely to the economic development but then the military on top of that, et cetera, et cetera.

And so my question is whether going forward you think that in doing the things that China feels will be in its interest to do will leave it in -- will have it behave in what we would interpret as assertive a manner, particularly in the region in this case, or whether they will feel sufficiently confident that they can protect and promote their interests and their claims and all the rest of that in a way that you were describing it, Richard, as more -- of more recent vintage, which also is what they did a few years ago when they overstepped and thought they hurt their interests.

Whether this more moderate approach to protecting and promoting Chinese interests will be something we should expect to see or whether the strategic vision is such that China feels it really needs to expand its influence, not necessarily its physical claims but its influence, in ways which will inevitably lead it to use its military capabilities in ways which are challenging to us.

MR. O'HANLON: So, Bud, do you want to start with Mike's question? And then we'll go to Richard.

DR. COLE: Well, I think it's a great point.

I believe that, as I mentioned earlier, China's focus -- let me back up a minute.

China's focus until maybe 10 years ago was pretty much strictly on Taiwan, and if you looked at naval modernization in China you could see the great emphasis in the last 15 years on building submarines, particularly conventionally

powered submarines. And I think this was done deliberately because they felt if they could deploy a couple dozen submarines they could preclude, or at least very much slow down, any U.S. intervention in the Taiwan scenario.

I think now that they believe they have achieved that they're going back to Admiral Liu Huaqing's three-phase strategy, such as it was, the third phase of which was to have a global aircraft carrier-based navy.

I would qualify that a bit. I think that the immediate goal is to be able to exert sea control out to what they call the second island chain by about mid-century. The second island chain down through Japan, the Bonin Islands, Marianas, Palau, and then around through Indonesia is certainly very ambitious. It extends out about 1,800 nautical miles from the coast of China. Whether or not they can achieve that by 2050 is still an open question.

They have, I think, made great progress in being able to achieve the earlier step that Liu Huaqing laid out, which is to be able to exert sea control within the first island chain, which runs through Japan through the Ryukyus, Taiwan and the Philippines, and then around to Indonesia. They've done that by virtue of not only submarines and other naval ships but by virtue of their land-based missiles and by air force capabilities.

I think that the Chinese military believes that Taiwan is no longer a problem from any sort of balanced measurement across the Taiwan Strait.

They are certainly focused, I think, still on maintaining -- or gaining control over the three seas. And by gaining control, I mean that I think Beijing wants to be able to prevent events from happening of which it does not approve within those three seas.

What we have seen -- and this may actually have become something of

a bit of an unexpected nature to the Chinese military -- is, as Mike mentioned, their ability not just to deploy these three-ship formations to the Gulf of Aden and exert counter-piracy operations, but many of these units now go beyond that, entering into the Mediterranean, even down the east coast of Africa -- excuse me, the west coast of Africa.

So I think we are seeing perhaps unplanned but nonetheless an expansion of the Chinese ability to deploy ships far beyond regional waters.

MR. O'HANLON: But not necessarily to the Indian Ocean or the Persian Gulf, if I heard you correctly.

DR. COLE: No, they are, in fact.

MR. O'HANLON: Doing some of that, but that's not their main goal.

DR. COLE: Well, since December 2008, of course, they've had the counter-piracy formations in the Gulf of Aden.

They are slowly beginning to deploy more and more ships into the Indian Ocean. The fact that earlier -- I guess it was last year -- they sent a conventionally powered submarine into the Indian Ocean. Certainly, it's gotten the Indian navy's attention.

The Indian navy, frankly, tends to take a bit of an exaggerated view of Chinese naval aspirations, but nonetheless, we are seeing increased distance deployments by the Chinese navy.

MR. O'HANLON: Thank you.

Richard.

MR. BUSH: On Mike's question, if I remember my world history correctly, there actually aren't too many cases of a continental power becoming a maritime power. The Soviet Union tried, failed. We're the only one.

So what China is setting for itself is not a small goal. It will be a huge

achievement if they make it.

On Alan's question, I agree with you that once you have the capabilities there's the temptation to use them, and I think that temptation isn't just in the minds of the PLA.

A friend of mine was vacationing in Hainan Island where the Zhangjiang naval base is, and the taxi was taking him to his hotel, and they were going by the naval base. The taxi driver was complaining and complaining about how the fact -- about the fact that China had spent all these money on these ships but it doesn't use them. "God damn it! Why don't we use them for something?"

More seriously, I think it's impossible to make a sort of general prediction about this.

I think that we are going to have to be on the lookout for cases, both recently and as we go forward, of exactly how China decides whether to use military power to deal with this specific problem. And here we get into something Bud has mentioned and I've mentioned, the quality of Chinese decision-making and its confidence, or lack of confidence, in its ability to control escalation and manage risks.

MR. O'HANLON: David, anything to add to these?

MR. DOLLAR: No.

MR. O'HANLON: Okay. Let's go to another round.

Let's see. I want to get a little further back.

Here in the front row. Do these two over here, and then we'll work back.

Please.

QUESTION: Thank you. My name is Genie Nguyen with Voice of Vietnamese Americans. Thank you for the opportunity and thank you for all the presentations.

I've heard all panelists mentioned the South China Sea would be the most risky and dangerous point, even all the factors that you brought up, and I've also heard about the geography and the message that the U.S. sent to China regarding sequestration and all of that information.

I would like to ask about the role of Vietnam and ASEAN in the big pictures, both economically and politically and military-wise as bases.

So we're expecting a code conduct. So where do you see -- for the code of conduct to be effective, pragmatically, we need to have a mechanism to enforce that. Where would the U.S. be in the enforcement?

And right now, we're talking about China is building islands, and if we let that proceed, that will undermine not only the U.S. but the whole international community and ASEAN as well, and most of all it undermines the international law which we are trying to bring forth in the code of conduct. So where do you see the U.S. can rally the United Nations Security Council to have something to say in it --

MR. O'HANLON: Thank you.

QUESTION: -- to firm it up, the UNCLOS?

Thank you.

MR. O'HANLON: We'll go to the woman in the third row here and then back to the panel.

QUESTION: Thank you. My name is Titilye Ogandeli. I'm a recent graduate from Syracuse University's Maxwell School with a master's in international relations, and I love this topic.

My question is actually for David.

As we all talked about, we talked about how China's economy has kind of been slowing and like last year it was 7.4 percent, I believe. And I just recently read

from the *Wall Street Journal* that there was some type of restructuring within the People's Bank of China and they were able to free up about a hundred billion U.S. dollars for lending.

So what do you think the implications would be economically, like overall for China, and also for their military and us, for us as well, for the U.S.?

MR. O'HANLON: David, would you like to start with that question?

MR. DOLLAR: Yes, yes. China's economy is slowing mostly for natural reasons. There has been over-investment, particularly in real estate but also heavy manufacturing and, I would argue, in local government infrastructure. So it's natural for the economy to be slowing down, and basically, it's a healthy thing that's been managed well.

But the authorities do not want the authority to slow too much, and so the most recent moves -- you know, they got some disappointing data. The first data coming in at the beginning of 2015 were disappointing in terms of both manufacturing performance and service sector. So they made a kind of typical monetary easing move to reduce the reserve requirement and free up, as you say, something around \$100 billion equivalent of additional lending. So that's a short-term macro move.

I think the -- for this discussion, I think really the important issue is more the kind of medium-term and long-term growth of the economy. China has a lot of reforms it needs to carry out in terms of the household registration system, financial liberalization. They still have a lot of closed sectors to their economy, and they would benefit from opening those up.

So I would argue those structural measures are really more important in terms of sustaining a healthy growth rate of the economy over a 5 or 10-year time period.

MR. O'HANLON: Richard.

MR. BUSH: Let's start with Bud on the South China Sea.

DR. COLE: Thank you. It's really an excellent question.

Vietnam is very interesting because it seems to me that if there's some sort of clash between Vietnam and China over the land features or drilling rights in the South China Sea on Monday, on Wednesday, the head of the Vietnamese communist party and the head of the Chinese communist party are having a love fest somewhere.

So Hanoi is obviously trying to keep a balanced view, which goes back to the point of geography. China is right here. You know, the Chinese army can walk to Vietnam, and the U.S. is a long way away.

But I think this idea of balance also explains why Hanoi is striking up such a much closer relationship with India. Indian navy guys are training the first submarine crews in Vietnam, for instance, and there's an agreement that Indian navy ships can be repaired in Vietnamese shipyards. But Vietnam is going to be very wise about this, I think, as the balance goes forward.

As far as the code of conduct is concerned, the 2002 decision to design a code of conduct has made sporadic progress at best, and I don't know that the U.S. is ever going to have any role in enforcing that. I'm not sure who would be available to enforce it.

I think Beijing is going to maintain its position that even within a general code of conduct that the bilateral relationships are going to have to decide who's right and who's wrong in a given situation.

I also know in respect to island-building that I think Malaysia was the first to do this on Swallow Reef, and the Philippines and Taiwan have also dredged dirt and expanded island facilities. Certainly, China is doing it on a much greater scale than anybody else has.

The interesting point will come when, under the United Nations Convention on the Law of the Sea, should China try to claim UNCLOS rights for these manmade structures. While UNCLOS is very clear that manmade structures don't qualify as islands, that's something in the future that will have to be decided.

I re-read the UNCLOS this morning before coming down here and was once again struck how a treaty, an international treaty, can be so indefinite, with so many gray areas and points that have yet to be decided.

MR. BUSH: Just to supplement Bud's remarks, I am not holding my breath about the conclusion of a binding code of conduct. I think China, at least, may not want to restrict its flexibility by accepting rules.

I think that if we ever get to it, the enforcement would have to be among the countries concerned, but I do think the United States believes it will be very useful if the countries concerned can have a binding code of conduct.

On Vietnam, I think -- I agree with what Bud has said.

Another thing to be said about Vietnam is that it does have a capable military and that can be a force for stability, and you can contrast the capability of the Vietnamese military with the military of another Southeast Asian nation that I won't name.

MR. DOLLAR: Can I say one word on Vietnam?

I just have to add that I think Vietnam has this great opportunity because it's one of the initial negotiators of the Trans-Pacific Partnership. So if the Trans-Pacific Partnership can be completed and implemented and Vietnam can meet the standards, Vietnam will actually be the biggest winner relative to its GDP. So this would be a very important measure for Vietnam that would tie it more closely to the United States and Japan, economically.

Now it would be good if China eventually joins a successful TPP. That

will be great for the whole Asia region. But whether or not China joins, it's a great opportunity for Vietnam.

MR. O'HANLON: By the way, two factoids as we look to the next round.

Speaking of other countries, we haven't talked a lot about Australia today. They have a very good fiscal position, and yet, they're only spending about, I think, 1.6 percent of their GDP on their military. So that gives you some gauge of their relative concern about China; it's real, but it's not through the roof.

Likewise, there's a lot of talk about Prime Minister Abe remilitarizing Japan, and obviously, there are a lot of interesting things going on in Japan, many of which I personally support, some of which I'm concerned about. That's probably true of many on the panel.

But I would note that Japan's military budget is still plus or minus 1.0 percent of GDP, and it has virtually not moved from that very low post-World War II ceiling despite all the talk of Japan doing more.

So I think it's interesting as people talk sometimes about arms races in Asia, et cetera. If there are arms races, they're within certain constraints.

I would just offer that quick perspective.

Pat Mulloy and then the gentleman in the blue vest.

QUESTION: My name is Pat Mulloy. I'm a trade lawyer, but I'm also a former member of the U.S.-China Commission, and my question is to Mr. Dollar.

The Chinese use a term called comprehensive national power. It means you build your economic strength, and upon that you will build your military and your political strength.

We're concerned. I think the title of the program is about China's rise and why we maybe need to increase our defense budget or deal with that.

My understanding is since China joined the WTO the United States has run about \$3 trillion worth of deficits with China. Last year, our trade deficit with China was \$340 billion. Some economists would say that this is contributing very much to China's growth at the expense of our own growth and jobs in this country and economic strength in this country, but we're feeding China's growth.

Wouldn't it make sense, as part of a pivot toward Asia, to begin to rebalance this economic relationship so that it's more balanced rather than feeding China's growth at our own expense?

MR. O'HANLON: And then here.

QUESTION: My name is Martin Apple from Berkeley, California.

My discussion point is very straightforward and simple. All the big things that you're measuring have a common vulnerability, and that is the cyber connection between them. And since we know about advanced persistent threats and sleeper agents and all these things being developed on both sides of the oceans, shouldn't we be tracking this just as much as all the others because it really underlies their success?

MR. O'HANLON: Thank you.

David, do you want to start with the trade question? And then we'll go to the cyber question.

MR. DOLLAR: Yes. I share the sentiment behind your question.

And certainly if we go back a number a years, if we go back to the period before the global financial crisis, the imbalance between the United States and China and, just more generally, imbalances in the world had really reached extreme levels. China's overall surplus got above 10 percent of GDP. U.S. overall trade deficit was around 7 percent of GDP, and lots of people were warning that that was unsustainable, and that proved to be true.

Now I would argue that we've made quite a bit of progress with rebalancing since the global financial crisis. It really makes sense to look at the overall imbalances. Right.

If the U.S. has a trade deficit with China, if that were balanced with other trade surpluses, then it wouldn't really be such a big concern. Our overall deficit has come down to about 3 percent of GDP. China's overall surplus has come down below 3 percent of GDP. I think those are sustainable numbers, and there are reasons why that may not be disadvantageous for the United States.

My worry now is that those imbalances are going to start rising again. U.S. economy is finally beginning to perform in a healthy way, and our trade deficit is widening. You probably saw the December numbers were somewhat disturbing. So it's definitely an issue we need to continue to focus on.

One aspect is the exchange rate, where we have an intense dialogue with China and there's been a certain amount of progress in terms of China letting its currency appreciate

At this point, I feel the bigger issue is market access. China remains closed in many important sectors, both in terms of trade and foreign investment. I think it's in China's interest to open up those sectors. It would have a significant effect on the United States' economy; the United States would benefit from being able to export more and invest more in China.

So I think that's where the dialogue is now, and that's why things like Trans-Pacific Partnership and potential bilateral investment treaty between U.S. China -- these are very important because these would signal that China is serious about opening up and kind of meeting international standards that are appropriate for its level of development.

So I think things are kind of hanging in the balance now as to whether we make that progress in terms of market access. If we don't, then I think there's a danger that those big imbalances are going to come back, and the U.S. will then have to think about other potential strategies.

MR. O'HANLON: Richard or Bud on cyber.

MR. BUSH: Thank you for that question.

I think you make an extremely good point if only because the most difficult military domains, or security domains, to manage are the new ones where you don't have an experience and sort of at least informal rules on how to conduct yourselves.

I think cyber is doubly tricky because the attribution problem is so severe. I think that if there were problems with the PLA navy or the PLA air force or PLA missiles we would probably be able to figure out pretty quickly that China was involved. Cyber-attacks are a different story. So this deserves all the attention it's getting and should probably get more.

The first requirement, I think, is for our institutions to build up their defenses in a serious way, whether it's U.S. government, U.S. critical infrastructure, U.S. corporations.

It probably doesn't hurt if we also build up fairly robust capabilities to remind China that we're not just going to play defense.

Ultimately, the management of this new domain is going to require diplomacy and creation of rules where rules don't exist. Now that may be a tall order, but it's certainly something to try and achieve.

MR. O'HANLON: Okay. Let's go to another round of questions here. I'm going to go one more time in the back before maybe going up to the front.

So the gentleman about four rows from the back, and then we'll go to the gentleman standing way back against the wall.

QUESTION: Thank you. I'm Marc Wall, recently University of Wyoming, formerly adviser at the U.S. Pacific Command.

First, how would you say China is reading the situation in the Ukraine? What lessons may it be drawing, or not be drawing, from the West response there for its approach in the three seas?

And, secondly, Taiwan may not be the focus of China's military buildup these days, but Taiwan is facing new elections, and it looks like it may become a bigger risk factor in the region. To what should we be paying attention there?

MR. O'HANLON: And then in the back, please.

QUESTION: Hi. Nick Weinstein from the Hudson Institute.

My question is aimed at David, but I appreciate any input from any of the panelists.

My question is once, or if, China catches up with the U.S. or surpasses the U.S. in terms of economy, what will it contribute to the world order and how would that look like, specifically in terms of global institutions and global power structure?

Thank you.

MR. O'HANLON: David, would you like to start?

MR. DOLLAR: Yes. As I see it, China is pretty well-embedded in the current set of global institutions. It's a Security Council veto country. It's an important member of the IMF, of the World Bank, the World Trade Organization.

Now within those groups, the economic groupings, which I'm more qualified to talk about, there's broad agreement that the power, the voting shares, et cetera, they should be shifting away from the developed economies towards the

developing economies.

I emphasize the point that the U.S. can aspire to keep roughly its share of world GDP, which I think is a realistic aspiration.

But that's not realistic, frankly, for Europe or Japan because of their demographics and other factors. Europe and Japan are likely to be a slightly slowly declining share of the world economy, and developing countries as a whole are likely to be a gradually increasing share of the world economy. And that has a lot of positives because, remember, most of the people in the world live in developing countries.

So, in terms of those institutions, it makes sense for the voting shares and the power to be shifting to the developing world, and that's broadly accepted. In the IMF, there was an agreement about reallocating quota shares.

Now, unfortunately, the U.S. Congress has not ratified this agreement, and I don't see prospects particularly good in the near terms for the U.S. Congress to ratify this.

So it's fair; from the point of the Chinese, it's fair to say there seems to be some reluctance on the part of the United States and the existing powers to let China kind of take its natural place in these institutions.

So I see China now hedging to some extent. It's still an active member of those existing institutions, but it's starting the new Asian Infrastructure Investment Bank, perhaps a BRICS bank, a Silk Road Fund. I see that as Chinese hedging behavior that makes a lot of sense. I hope the result of that is to galvanize the existing powers to accept that power within the existing institutions should be shifting.

I would relate this also to the Trans-Pacific Partnership. The Chinese perceive that to some extent as an effort on the part of the U.S. to exclude them. I see it as an effort on the part of the U.S. to set new high standards for trade in the 21st

Century. I hope that it succeeds, and I hope China joins.

So I think this is an interesting moment in history, where over the next decade or so it will not be clear if China is really throwing its weight into strengthening the existing institutions and having kind of a well-agreed set of economic rules or if China will gradually be shifting more toward developing an alternative set of institutions, which I think is not likely to be a good thing for the world economy.

So I think it's indeterminate right now, and I think there are a lot of things we can do to encourage China to be playing in the existing institutions and bolstering those.

A lot of economics is win-win. So, on the economic side, it would be good if we could agree with China about economic rules that lead to more trade, more investment.

MR. BUSH: Marc Wall and I were colleagues some time ago at the American Institute in Taiwan.

It's really nice to see you.

I haven't studied China's view of Ukraine closely, but I expect that they would have a mixed view.

First of all, there would be deep concern about what they perceive, underline perceive, as the U.S. stimulating this "Color Revolution." From at least some Chinese views, the situation that we have today was started by the United States, and there's a not -- they don't focus as much on the internal reasons why the intra-Ukraine dispute occurred, and we see this replayed in their view of the situation in Hong Kong, for example.

Second, they may see a couple of opportunities. One is if the United States gets deeply involved in the dispute between Ukraine and Russia that may distract

and divert us from paying so much attention to East Asia and so much attention to them.

Similarly, there may be sort of a view that if we can strengthen our relationship with Russia that is a useful card to play against the United States.

I hope they would think twice about moving too close to Russia, which after all is a country that violated an international treaty in facilitating the breakup of Ukraine.

I think, in particular, they should worry about the precedent that Russia has set by stimulating separatism in a small entity particularly through a referendum. And at least some people in China, with maybe a sense of humor, would see an analogy there.

Thanks.

DR. COLE: I certainly think Richard hit that nail on the head.

And I'd just add with respect to Taiwan, I did not mean to infer that Taiwan's importance in Beijing's strategic thinking had been reduced, but that from a military estimate by the PLA I don't think they believe that the Taiwan military is a significant opponent. I think that the PLA military in a Taiwan scenario is much more concerned about U.S. military intervention.

Having said that, I'm not sure that the PLA calculations of that sort are always very accurate. I think for the last decade and a half, at least, I've become convinced that the PLA has grossly underestimated the capability of the Japanese self-defense forces, for instance.

But certainly in terms of strategic importance, I think Taiwan remains at the head of the list in Beijing.

MR. BUSH: Marc, I'm sorry. I didn't answer your Taiwan question.

I really think it's way too early to make a sound judgment. We do not yet

know who the candidates will be although people think they know. We do not know what the mainland policies of those two candidates will be. We don't know who will win. And so there are a lot of variables at play.

I do fear that there may be an overreaction on Beijing's part if Dr. Tsai Ing-wen were to become Taiwan's next president, but I hope that they would not overreact, remain restrained, and see how the situation develops before taking any kind of preemptive or assertive action.

MR. O'HANLON: One last point on Ukraine, and then we'll go to our final two questions.

I think another dimension to this is to what extent is American policy in Ukraine seen as having been sufficiently resolute.

I'll use this as an opportunity to do an advertisement. Susan Rice is going to be up here in 90 minutes. Whether you're here or on C-SPAN, that one too will be covered live, and she'll be talking about the President's national security strategy where these kinds of linkages are certainly on people's minds.

I'm not a complete defender of administration policy on Ukraine or anywhere else, but I would observe personally that I think there's actually been a salutary effect, a beneficial effect, in that whether what we're doing towards Putin with sanctions is adequate to stop Putin it's a pretty good deterrent against a truly rational actor doing something similar because I think the Chinese, frankly, are a little more capable of rational decision-making than Vladimir Putin right now.

And the economic consequences of the sanctions, again, may not be enough to get Putin to desist, but they're a pretty powerful signal to other would-be aggressors that the world community is capable of applying sanctions, I think, in a more effective way than we were before and in a way that has a certain bite.

So at least that's an optimistic interpretation, but I think there's something to it as well.

So let's see. We've got time for two more questions. The woman here in the fourth row and then right behind her, and then we'll be done.

QUESTION: I'm Lieutenant Margaret Morton. I've just been in WESTPAC for the last four and a half years, and I'm now here in D.C.

So I have a couple questions.

You talked about defining the ends to then determine what our means would be on the subject of China's expansion and our policy towards it. If you could define those ends, my question would be: What would your answer be?

And if you could put any percentage of our GDP towards our defense spending, what do you think it would take in order for us to maintain our position and our role of forward presence?

Following on that, if sequestration does go through, how would that affect our policy in terms of relying on our allies to support our role there since we did discuss China kind of pushing us out towards the second island chain, and what would it take for us to maintain our position?

MR. O'HANLON: Thank you.

And the last question here.

QUESTION: Gil Rozman, formerly of Princeton and now the Asan Forum.

Richard, when you brought up what China should think about what Russia is doing, I think you underestimated what China is doing about that, and one thing is strengthening military ties with Russia.

So what can Russia sell China?

What is the possibility, since this is the main theme here, of a strengthened Chinese military through new connections with the Russian military, and how should the U.S. respond to that?

MR. O'HANLON: So I think what we'll do now is we'll just work down the row and answer your question and any concluding thoughts folks may have.

I'll begin with one thought on U.S. military spending.

I don't want to peg things to a certain percent of GDP looking out indefinitely into the future.

And, by the way, even if sequestration occurs, I'm hopeful that the dynamics of the presidential race next year will change the calculus and the politics in the United States. So it wouldn't last more than two years, I hope.

Let me just say the following, that I think there is a case for modest real increases in the U.S. defense budget above and beyond the inflation rate, and here's a very, I hope, stark way to put it that I hope is compelling.

As you know, a big part of the rebalance strategy, the pivot, the military undergirding of that is largely U.S. Navy, and the central concept there is to now base 60 percent of the navy in the Asia-Pacific theater instead of the historical norm of 50.

But that only makes much sense if the navy is either stable in size or growing because, otherwise, you have 60 percent of a smaller force which may wind up being less than 50 percent of the old force.

And if you do the math, sequestration is roughly at the crossover point. In other words, it would force a reduced fleet size if it was to stay into effect over a long term, which would probably be in the range of, let's say, 240, 250 ships, maybe even a little less.

And 60 percent of that is no improvement relative to 50 percent of where

we are today, which is about 285 ships. It's more or less a wash.

So, if you're trying to send a signal of American reengagement, you have taken your ability away to do that by sequestration.

So, to me, that's a very clear way that I hope relates the rebalance strategy to the defense budget, and it's a reason why I am strongly against sequestration.

I don't think we need a huge buildup, but a nice, steady, gradual, real increase would be, to me, a good thing.

Bud, over to you.

DR. COLE: Well, thank you.

If I had a real good answer to the ends-means question, I'd probably call the Secretary of Defense this afternoon and let him know. But it's a very important question, and it has to do with the entire military industrial complex in this country.

By the time the latest aircraft carrier is deployed, it's probably going to be a \$20 billion machine if you count the air group that's on board. I don't know that even the United States is going to be able to afford that in the long range.

A personal preference, I'd much rather see us deploying 20,000-ton displacement ships with a few hundred UAVs on them, but that's heresy, as you all know.

The forward presence point that Mike has just addressed is really critical and goes to a much more important long-term rest-of-this-century or mid-century strategic question for the United States. Are we going to be able to afford to, or should we, maintain this forward presence that all of us have talked about a little bit here?

Do we need -- in the case, for instance, of 2050, trying to look ahead and see the status of Japan, Korea, whether unified or not, China and so forth, is it going to be necessary or worthwhile for the U.S. to maintain a military presence in Northeast Asia? That's just one example.

I think one could argue that it's not; it would not be necessary.

Your final point, though, I think goes back to something several past CNOs, maybe almost 20 years' worth, trying to engage more active participation by our allies to maintain the forward presence that we believe to be necessary today.

When Admiral Mullen came up, I think he was the one with a 1,000-ship navy, for instance, the idea being that we rely on our allies. That's much more than just relying on the Japanese maritime self-defense force or the Republic of South Korea military which, obviously and understandably, is very focused to the north.

Once, should the peninsula be unified, I don't see the rationale for believing that Seoul would want to extend military participation much beyond the peninsula.

As far as the Southeast Asian nations are concerned, I think once again geography counts very much. And at the first sign, or not the first sign, but should it become apparent that the U.S. forward presence is going to become a declining forward presence, I think we're going to see a shift in foreign policy emphasis by those nations.

MR. O'HANLON: Richard.

MR. BUSH: I'll pass.

MR. O'HANLON: David, any final thoughts?

MR. DOLLAR: I just want to emphasize again that our economy has started to grow. It's growing reasonably well. It has potential, certainly in the short run, to grow at about 3 percent in real terms.

So we have the capacity to spend more money. Just because we have the capacity doesn't mean we should do it. But as the economy expands, just intuitively, it makes sense that there's more infrastructure needs, there are more education needs, and potentially, there are more national security needs.

I'm not the person qualified to talk about that, but as the economist in the group, there's certainly the potential to spend more resources. And many of the areas I know, like infrastructure and education, if you don't spend money, then what's going to happen is the economy is going to slow down and you've basically shot yourself in the foot.

So I hope we don't get stuck in a moment in history where we feel that we have to hold spending constant in real terms or reduce it in real terms when, in fact, our deficit is at a sustainable level and our economy is growing well and so we have the potential to meet various needs that will continue to make our economy grow well.

MR. O'HANLON: So let me take the prerogative of the chair to thank you all for being here, to ask you, as I've just been told, if you're going to stay at Brookings, please enjoy our cafeteria across the street, or across the hallway, but we are asked to leave this room fairly quickly because they have to get ready for Susan Rice, to wish my mom a happy 80th birthday, but to ask you to join me in thanking the panel for an excellent presentation.

(Applause)

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