



## Opinion

Kenneth Lieberthal

# Is China Catching Up with the US?

**While China has emerged as a key player in global affairs, significant challenges to its ongoing development should not be underestimated, argues Professor Kenneth Lieberthal of the Brookings Institution.**

**R**ecent relations between the US and China have been wide-ranging, serious, mature, and basically cooperative — in the sense that both sides want to see the relationship work. The US-China relationship is one of deep interdependence, whether in trade, security issues, or a number of other aspects of international affairs. Each does better because the other is doing reasonably well, and if either nation runs into deep trouble, it affects both of them. Although there are significant disagreements, there are also common or compatible interests on major global objectives at a broad level. Both countries want a world that is basically stable and peaceful; both seek prosperity as a very high priority goal; both want the world to be able to engage more effectively in the fight against climate change; both feel threatened by terrorists and cooperate on counter-terrorism initiatives. Both leaderships want the bilateral relationship

to go smoothly. Neither is seeking to cause a major problem for the other as a key objective of national policy.

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In a sense, as President Obama has suggested, no bilateral relationship in the world is now more important than the one between the US and China. Since early 2009, truly global issues have moved to the centre of the US-China relationship for the first time: recovery from the global economic and financial crises and the related restructuring of the global financial system; nuclear proliferation in North Korea and Iran and beyond; climate change. It is certainly the case that these and other major global issues

become potentially easier to manage if the US and China can either cooperate in dealing with the issue, or at least act in a reasonably parallel fashion in their approaches to the issue. Conversely, every global issue becomes much more complicated and difficult to manage if the US and China are fundamentally seeking to undermine each other in their respective approaches.

Related to this new understanding – that China has become a critical player in dealing with global issues – is a significant shift in perception that the gap in what might be termed **Comprehensive National Power (CNP)** – overall hard power, economic capability and reputation – has narrowed between the US and China. This is a narrowing that has resulted primarily from the different track records and responses to the global financial and economic crises. The US suffered enormous losses over the last two years. At the same time, China has fared better than any other major economy in the same period, and has emerged from the crisis with lower levels of government debt than any other major economy, meaning that it has more degrees of flexibility going forward, financially, than the rest of the world.

There is probably no consensus in China as yet about how it should position itself on major global issues,

and the extent to which China should move from being a developing country narrowly defending its interests to being a global power that takes on greater obligations in contributing to global common goods. The move to the centre stage of global issues is too fast to be a comfortable transition for China. While the mood in China is very much a feeling that China has almost drawn equal to the US in CNP, China's top leaders suffer no such illusion, and are well aware of the challenges it faces. Nevertheless, the popular sensibility, even among the intellectual class, is that the gap has narrowed dramatically, and momentum is all in China's favour.

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This sensibility is based on a number of misperceptions. The first is that the US is so deeply in debt to China that China can call the shots. The reality is that China holds less than 7% of outstanding agency and sovereign US debt – it is the largest single holder of these categories of debt, but 7% is not significant enough to dictate terms, especially since the US is selling unprecedented amounts of

debt now at very low interest rates. Thus even as China is reducing its purchase of new debt, the US is having no trouble selling it. China, meanwhile, has placed an enormous bet on the US economy by dedicating a very large percentage of its foreign exchange holdings to US debt; it is a serious purchaser, but with an interest in having the US economy do well, because it cannot easily exit. It is in the interest of both sides to maintain a good relationship and keep moving ahead in this situation.

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Secondly, there is a strong feeling, particularly in light of the recent global crisis, that the Chinese system of economic governance has been the key to its economic success, and represents a superior model for economic development; a “Beijing Consensus” in contrast to the Washington Consensus. This is likely mistaken: for China, this was not a financial crisis; its banks were not involved in the kinds of debt that deteriorated so badly. Instead, China experienced only an economic crisis as

export markets contracted sharply for China. The response the Chinese took was to flood the whole system with liquidity, the consequences of which have yet to be determined. Fundamentally though, even if China’s economy has performed well so far, the current model — which is reliant on cheap labour and exports — is not sustainable. Labour costs are going up rapidly, and may skyrocket by 2015 as the number of new entrants to the labour force goes down dramatically. The economic malaise in Europe, North America and Japan will make it hard to support export-driven growth going forward. Furthermore, economic development in China has been rapacious in its exploitation of the environment to a degree that cannot be sustained — the lack of usable water, for instance, will become an accelerating problem. Wildly unbalanced growth may lead to problems due to increasing social inequality and resultant discontent, even from the middle classes concerned over rising property prices. Finally, the pervasive, enterprise-by-enterprise engagement in the economy by the government makes it very hard to resolve issues such as corruption, violation of intellectual property rights and local protectionism against goods from other parts of China without fundamental reform of the entire political economy. It is still uncertain whether China can

undertake the structural reforms in how they manage the economy that will sustain rapid economic growth in the next five years; what this does suggest is that there is no “Beijing Consensus” that can guide others’ successful growth.

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The third dimension of whether China is drawing equal, or nearly equal with the US has to do with underlying strengths and fundamentals. The US still has the highest GDP in the world, while China’s is very much smaller, in both absolute and per capita terms. China simply does not yet have high quality corporations that know how to run global operations or leverage technological change effectively. Indeed, China’s economy is dominated by state-owned, vertically integrated enterprises, whereas for the past two decades, multinational corporations have been going in the opposite direction towards de-integration and focusing on being very niche, innovative, high value-add players. Global corporations have become enormously flexible because they are not vertically integrated and no


longer have to maintain their current product lines to keep the corporation going, whereas China in some ways seems to be rushing headlong into the 1980s in terms of basic corporate strategy. China is just beginning to jumpstart its technological base for innovation, whereas the US already has a very advanced and enormously effective system for ongoing innovation. The US has a higher education system that took many decades to construct; China is expanding its system at a startling rate, but it still takes several generations to build a mature, quality higher education system.

In terms of other aspects of national strength, the US has military power that is truly global and by far the most advanced; China is beginning to acquire long-range capabilities, but still lags behind. In addition, China has a skewed age distribution in its population that bodes ill for the future. Due to a combination of rapidly declining fertility in the 1970s and population control in the 1980s, China now has an unusually high percentage of its population in working age, as against dependents either too young or too old to work. By 2015, the population structure will begin to invert and, by 2030, China will look much like Italy and Japan, in terms of national age distribution, but it will still be a developing country

in terms of per capita GDP, which is a very challenging situation. This is a population age pyramid the US has avoided only because of significant immigration flows. Finally, the US has had many decades of experience in thinking and acting as a global power. China is now being thrust into the position of being a global power but without the mindset yet to necessarily handle that comfortably.

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All this is not to say that America is in good shape or does not face major problems. Instead, it is a reminder that China's leaders are accurate when they say that China is still a developing country — albeit one with some remarkable achievements. In a sense, China, with a little over 1.3 billion people, really consists of islands of modernity populated by perhaps 450 million people, surrounded by a sea of over 800 million people that is a developing country. And the two interact in every way, every day, all the time. It is this interaction between a developing country and a developed

country that defines the problems of China and the opportunities. Most foreigners go to China and never see the developing country side of that equation, but it critically defines the equation. It will take a number of decades at a minimum to transform China into a fully developed country. Those who assume that China can roughly match the US in capabilities now, therefore, are bound to be frustrated and disappointed by many of the things that may develop in the coming few years. 

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