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The geopolitical impact of China’s economic diplomacy

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Probably capital flow is even more important. If you look at the needs in the developing world, the Asian Development Bank just came out with a study saying Asian developing countries need to double their investment in infrastructure, an extra $900 billion per year, if I remember correctly. Most of that financing has to come from domestic sources, but foreign capital can play a very important complimentary role. It can be an important catalyst. So, developing countries are looking very much for foreign investment into infrastructure, either through development banks or private investment, or sovereign borrowing. Beyond infrastructure, developing countries are also trying very much to attract direct foreign investment. This is an important way to get into global value chains, to get new technology and marketing skills. This is well established in the literature, that direct foreign investment helps developing countries accelerate their progress.

Now, I think it’s fair to say that looking at these needs, in recent years, the rich countries as a group have not been doing very much to meet these needs. We have not seen much capital flow, much of any capital flow, from rich countries to poor countries. In fact, a lot of the time we have what we call “capital flowing up hill,” meaning leaving developing countries, coming into the rich countries, rich countries growing slowly and tend to have large fiscal deficits and fiscal problems emerging. Rich countries really have not been doing a very satisfactory job of creating a good environment in which developing countries can prosper. That’s my first point, that’s kind of background.

Second point, China is very well positioned to come in and meet these needs. I can answer one question. Richard was asking is this good for Chinese people. I think the answer to that one is pretty clearly yes, because what is happening in China is China has a very high savings rate, and for a long time they primarily invested that at home, and that’s one source behind their growth. But frankly, they have over invested in a lot of sectors, and they have created excess capacity. You see it most clearly in real estate, lots of empty apartments, whole empty cities. Infrastructure. They have over build the infrastructure.

I have a good story from a Chinese friend about visiting Inner Mongolia, to a city, and seeing a bridge literally to nowhere, and asking the local government about the bridge to nowhere, and they said don’t worry, the five-year plan includes a river. (Laughter) First, we build a bridge, then we build the river. So, they have over build infrastructure, and then well documented excess capacity in heavy sectors like steel, cement, et cetera. So, what’s happening now is in that environment of excess capacity and declining returns, investment is slowing down, which is natural. The savings rate is starting to come down a little bit, but it’s very high and it’s only going to change slowly. So, it makes sense for more of this Chinese capital to deploy abroad in search of returns.

The Chinese population is aging. The labor force has already peaked and starting to decline. You’re seeing some labor-intensive value chains moving out of China. You see Chinese construction companies that do not have enough business at home. So, I think from China’s point of view, this capital going out makes enormous economic sense. If it goes to good investments, it’s going to benefit Chinese people. Now, that’s an interesting question, is it going to go to good investments.

The amounts involved are very large. The Institute for International Finance estimates last year $725 billion net left China in terms of commercial or private capital. That level is not sustainable. An interesting macro issue is whether or not China can manage this process to avoid instability, because that level of outflow is not sustainable. Certainly, China can afford $300 billion or so of net outflow on a sustainable basis, and potentially, that could be very helpful to the rest of the world. If the flow gets to be too large, then we are likely to see destabilizing things, not really the topic of today’s discussion, but the worry about the Chinese currency depreciating, capital flight, all of that is real, but I think stable 200 to $300 billion net outflow per year is sustainable and beneficial for China.

Let me also say briefly I’m focusing mostly on investment, but on the trade side, I would argue China could help the rest of the developing world by opening up more, because China itself is still quite restrictive in terms of imports, particularly in the service sectors, imports and direct investment into
China. Even in a lot of manufacturing, there are still restrictions in China. So, think of developing countries needing access to markets, China potentially could play the kind of role the U.S. did in the past, but we don’t see that at the moment. China is promoting a trade agreement in Asia, RCEP, which is really a low ambition trade agreement. So, I don’t see China providing as much on the trade side as on the investment side, but the potential remains.

It would be in China’s interest to open up its economy more. It’s something that many different economists around the world are urging them to do. I don’t see it happening in the immediate future, but looking out a little bit further, China could play a positive role with more trade liberalization perhaps as part of larger agreements. The third point I want to make is about the modalities through which this capital is leaving China. My punch line here is One Belt, One Road gets the headlines, but the United States gets the money. There are different modalities of outflow, but an important one is China’s direct investment, and will emerge pretty soon as the largest provider of direct investment in the world. This is largely commercially driven, and if you look at the top destinations, leaving aside Hong Kong and money centers, the top destination is the United States and other big destinations are the Netherlands and the United Kingdom. One reaction I have to One Belt, One Road is don’t get too excited about it. A lot of the money is going to the United States, the United Kingdom, Netherlands, kind of the usual suspects.

Now, having said that, it’s also true if you look at the top 10 destinations for China’s outward investment, that list includes countries like Russia, Kazakhstan, Indonesia. In general, there’s more Chinese investment going to other developing countries than we see from U.S. investment, for example, or European investment. So, China is more diversified. It is providing direct investment into quite a few places in the developing world, but don’t lose track of the fact that the U.S. is the number one destination. Now, aside from direct investment, China’s lending is also very important. Here, again, AIIB has gotten the headlines, and I think it’s off to a very successful start as a multilateral bank with I think about 60 members now, but it’s relatively small compared to the amounts we’re talking about.

Most of the Chinese lending to infrastructure is coming from China Development Bank or Ex-Im Bank. I think in general, developing countries welcome this as a new source of finance. In Latin America, for instance, those Chinese banks are lending more for infrastructure than the World Bank and the Inter-American Development Bank combined. They are certainly becoming important sources of finance. I think that aspect of Chinese capital outflow raises a number of issues. One issue concerns governance. In general, western finance, both private and official, tends to go to countries with better economic governance measured in terms of macro stability or indicators like property rights and the rule of law.

The Chinese finance is actually indiscriminate in the sense that if you go to Africa, you find some of the big borrowers have relatively good governance in the African context, and then some of the big borrowers are countries like Angola, DR Congo, that have poor governance. Latin America, Brazil is one of the biggest borrowers, but Venezuela is also a very large borrower. So, the Chinese money is kind of indiscriminate with respect to governance. I think that raises some issues. One issue is for Chinese people, are you actually going to get benefits out of the lending to the poor governance environments. Things are certainly not working out well in Venezuela. China will probably have to write off tens of billions of dollars in Venezuela, so you have issues of debt problems developing and debt sustainability. I just remind you there are plenty of well-governed countries in the developing world that are happy to be borrowing Chinese money for infrastructure. It is long term, relatively low interest rate, and I started by emphasizing that the needs are really very, very serious.

Now, aside from governance, there are other issues. Some of this money is quite concessional, the concessional packages, meaning you take it as a package. You get a Chinese contractor. You don’t really have any influence over who the contractor is. There is evidence that the environmental and social safeguards pursued by the Chinese contractors are not as good as say World Bank standards. So, I think there are real issues there. Now, having worked for the World Bank for 20 years, I can tell you that a lot of developing country clients are frustrated with the bureaucracy and the slowness of big institutions, you
know, like the World Bank. I had one minister in Indonesia tell me -- sorry -- Ethiopia -- tell me that if the World Bank promises a road, five years from now we might have a really well built road. If the Chinese promise us a road, 12 months from now we have a road. Now, I happen to think there are benefits in both approaches. I’m something of an optimist. I’d like to think that we will see some evolution of Chinese practices. I think we are already seeing some evolution of Chinese practices. I don’t think the existing standards from the World Bank and the other development banks are in any sense perfect, so there’s the potential to make developing countries benefit from more finance and perhaps done in a more flexible way. That is certainly what AIIB is trying to do.

My last point concerns balancing. I’ve heard this in Asia, Latin America, and Africa. I was just in Uganda last month. I heard very clearly the message I got from officials and civil society that in general the Chinese finance is welcome, building infrastructure, direct investment. In Uganda, a third of all the new investment in manufacturing, foreign investment, comes from China, so this is very welcome, creating jobs. There is a nervousness, and several people expressly used this phrase, we’d like to see the United States balancing China. In Asia, that certainly has a security dimension. In Africa, it’s more about economics and governance.

People are worried now, you know, the United States withdrew from the Trans-Pacific Partnership. I’ve argued before that the TPP is about the software of trade, and a lot of Chinese investment is building the hardware, the infrastructure. You need both, the infrastructure and the software. I see the U.S. and Chinese activities as complimentary, but now the U.S. has withdrawn from TPP, and it is not clear if it will survive. The U.S. is proposing to cut the budget of the State Department in foreign aid by a third. The U.S. gives very little foreign aid, but some of it is targeted very effectively. In Uganda, they are worried about what is going to happen in the HIV/AIDS programs. They like the U.S. assistance that is supporting the strengthening of civil society. You can see that as something that can help balance some of the issues and problems raised by China. So, I think there is a legitimate anxiety around the world about what happens as China emerges as the largest source of finance, but the U.S. seems to be withdrawing as a trading partner and as a global figure.

So, I’m generally optimistic that this Chinese emergence is going to be mostly benefitting developing countries. I emphasized you have some countries with poor governance where we already have some poor results, so it’s going to be complicated. It will be more successful if the U.S. remains engaged in the world, and if China gets integrated into a functioning global system rather than just pursuing its own initiatives without a global context. Thank you very much. (Applause)

DR. KAWAI: Good morning. My name is Masahiro Kawai. I am from Tokyo. I want to give a Japanese perspective to this question of the geopolitical impact of China’s economic diplomacy. A few days ago, Premiure Li Keqiang delivered the government work report to the National People’s Congress. One of the focus areas of his presentation was on the One Belt, One Road initiative, and the need to accelerate the negotiation, and to forge a bigger Asia-Pacific free trade area. So, I want to follow David in discussing this morning for about 10 minutes, focusing on this One Belt, One Road issue, trade issue, and some on AIIB, and some on Renminbi internationalization, and some on financial cooperation.

I think China is doing a very positive contribution in the area of financial cooperation in Asia. With the rise of China, with its expanding economic size, it’s very natural for everybody, not only China, everybody to expect China to provide more international public goods to the rest of the world, and along with that, we expect China to want to say more about how the international economic system should be organized. So, in that context, AIIB, One Belt, One Road, Renminbi internationalization, and other initiatives do have a lot of substantive foundations. They are based on China’s economic growth, economic expansion, and China’s desire or expectation to provide international public goods.

One important question we want to ask is through this exercise, does China want to challenge the existing system and somehow change the existing system in a way that is consistent with China’s overall political, economic, and even security interests, or is China doing this exercise in a way consistent with
the existing economic system. These are the big questions. I want to come back to these questions.

On AIIB, AIIB was set up at the end of 2015, and last year, the AIIB was pretty active. There were nine projects approved by the AIIB with a total amount of $1.7 billion. The size is not so big. It is less than 10 percent of AIIB’s operation. About 75 percent of this financing was made jointly with other MDBs, like the World Bank, ADB, and EBRD. Only 25 percent was financed independently by AIIB itself. By looking at the documents, my assessment is that China follows relatively sound environmental and social standards in these projects. For 2017, there are about 10 proposed projects totaling about $950 million U.S. dollars so far. Maybe more would be expected. Still, the total amount does not seem to be that big, and the proposed projects for 2017, almost all the proposed projects are co-financed with existing MDBs.

So, the AIIB seems to be following the practice of other MDBs, and the size is not so big, not so threatening from the point of view of ADB or the World Bank. David gave a more recent estimate made by ADB about the need for Asia’s infrastructure investment per year, about $1.7 trillion U.S. dollars. That is a huge amount including environmental investment, climate change adaptation and mitigation. So, AIIB’s approach is highly welcome. AIIB is operating under the existing system. We are hoping this trend will continue. Now, the One Belt, One Road initiative, which was proposed by Xi Jinping in 2013, began to take shape in 2014, there are various economic corridors proposed, six economic corridors are proposed, but my judgment is the Belt and Road initiative is not simply limited to those six economic corridors. Many other projects that are linked to these corridors seem to be defined as Belt and Road initiatives. Actually, many local governments within China are now using the Belt and Road initiative as sort of part of their own economic development strategy, and if their projects are defined as Belt and Road, it looks like it is easier for them to get approval from Beijing.

So, there are so many projects, and so many projects are called BRI, Belt and Road initiatives. At this point, it is kind of difficult to make a sound judgment about the success or failure of BRI. I think China wants to seriously think about how to organize Belt and Road initiatives, because internationally, there are so many initiatives. Even for the Northeast Asian countries, like Mongolia that has its own initiative called the “Step Road Initiative,” which connects Mongolia with neighboring countries and distant countries. Korea has the Eurasian initiative, which connects Korea with Eurasian countries, and Russia has its own initiative, Siberian Transport System, and Eurasian economic partnership. There are many other such projects driven by various national governments. China is not the only country that is proposing huge cross border international projects. I think there is a need to coordinate these various types of projects rather than projects being bilateral between China and country A, China and country B, China and country C. These projects have to be well coordinated.

So, this process is very, very important to establish for China, and also there is a need to develop some indicators according to which people can make assessments about the success or failure of the Belt and Road initiatives. Basically, more professional/technical approach would be needed to a Belt and Road initiative, and a lot of coordination would be needed in multi-lateralizing this process by involving many countries, where Hong Kong Trade Development Council research section identified 65 countries as BRI countries. My impression is there are many more countries than 65. So, coordinating all these countries’ interests may be very difficult, but certainly it will be more productive than taking a bilateral approach.

Now, FTAs. China has been aggressive in pursuing FTAs after its joining the WTO in 2001. China has been an active participant in the ASEAN Plus Six FTA called “Regional Comprehensive Economic Partnership.” It is very important as Li Keqiang mentioned, RCEP is considered to be a pathway to a greater Asia-Pacific free trade area, so on this front, the U.S. is back tracking, which is very unfortunate, both TPP and RCEP are considered to be pathways to an FTA AP, FTA for Asia-Pacific, and now TPP is not there, which is very, very unfortunate, but does this make China an aggressive leader? I fully agree with David that China doesn’t seem to be taking leadership by opening its economy and then embracing many other countries and to consolidate on FTA and now RCEP. That is not what is
happening. What’s happening is that Japan, Australia, New Zealand, they are pushing high quality trade arrangements within the negotiation, and China, India, and countries like Indonesia are saying a high quality FTA is not realistic, a low quality FTA is something we want to pursue. So, there has to be some compromise between Japan, Australia, and New Zealand, and India, China, Indonesia. China is not taking leadership, which is very unfortunate.

If TPP had been in place, perhaps greater pressure would have been imposed on countries like China, and they might have felt that they would have to come up with RCEP as soon as possible, but it looks like it may take some time for RCEP to be realized. On TPP, it’s very unfortunate. I have a proposal to the Japanese government on TPP. Japan should go ahead with the existing TPP without the United States, which has withdrawn. That’s okay, but don’t change any text, don’t change membership, so the existing 11 countries, aside from the United States, can come up with a TPP that they have signed so they can implement without a TPP. So, what is needed is to add some statement to Chapter 30, which defines conditions under which a TPP would be implemented. A condition was six countries have to ratify and 85 percent of GDP would have to be covered by those six countries or more. Now, the same condition except the U.S. doesn’t have to be there. That means Japan is the largest economy, so Japan and Canada would have to participate, and countries like Australia and Mexico are encouraged to join. Then the 21st century trading and investment rule is set, even though it’s not sanctioned, the U.S. is not there, but the U.S. can always come back. I think that would provide a sort of standard for the Asia-Pacific.

I think I may be running out of time, but if I can have one minute. Financial cooperation, this is an area where Japan and China have been working very closely on ASEAN Plus Three, the Chiang Mai Initiative and also an institution like AMRO, ASEAN+3 Macroeconomic Research Office, which conducts surveillance. Japan and China have been working very closely despite the political problems between the two countries on Senkaku. So, that has been excellent. The most recent event is Mongolia. Mongolia has just completed IMF negotiation, and Mongolia is getting a total amount of $5.5 billion or so. IMF provides about $440 million U.S. dollars. World Bank, ADB, Japan, and Korea also are providing financing, and the People’s Bank of China is extending a currency swap arrangement so that Mongolia would not have to use foreign currency for trade settlement with China. So, basically together with IFIs, IMF, World Bank, ADB, three countries, Japan, China, Korea, they are now helping Mongolia, which is quite good.

So, in my conclusion, is China challenging the existing system or is China providing a complimentary arrangement to the international economic system? My argument is China has been working within the existing system but at the same time, China wants to go beyond that, like Belt and Road initiative, and potentially AIIB. What we want to continue to see is how China is shaping the Belt and Road initiative, is China going to do that within a multilateral framework or is China going to do it in a unilateral way? So, let me stop here. Thank you very much. (Applause)

DR. FEIGENBAUM: Thanks, Richard. It is always good to be back at Brookings. Every time I speak here, I get a different topic, thus, demonstrating the complete incoherence of my career. (Laughter) I think partly to encourage a division of labor, Richard asked me to focus more on the strategic and political side than on the straight economics, which I’m happy to do. To do that requires first that we bound the problem a little bit so that we’re not talking about the entire world. So, I’m going to focus mainly on Asia, East, Central, South, so Asia writ large. It requires that we not just talk about China, we put some other countries in the picture, which is good because this is a U.S.-Japan event, so I’m going to stick the U.S. and Japan into this a little bit. It requires that we flip it and think a little bit about the countries that Chinese money is flowing to, so we can talk about what Chinese money has meant or hasn’t meant to them in a political and strategic context, not just China. So, I’ll do that a little bit, and I’m also going to try to be a little bit prescriptive, if you don’t mind.

By way of background, back to the incoherence of my career, in the mid-2000s, I was the deputy assistant secretary of state for Central Asia, and then for South Asia, even though my background was
mainly on East Asia, with a heavy emphasis on China. That was part of an effort by my then boss, Condi Rice, the secretary of state, to reorganize the State Department, one piece of which was to take the Central Asian countries, which hitherto had been in a westward focused bureau, the Bureau of European and Eurasian Affairs, focused on Russia, looking West, and attach them to an Asia focused bureau with the countries of South Asia. Part of that was tied to American strategy in Afghanistan. There was this notion of breaking landlocked Afghanistan out of its dependence, giving it economic opportunities. That was a bit of a pipe dream.

But, I think the larger point was to start thinking about Central Eurasia in a way that looked toward the most dynamic economies in the world, to which they were contiguous, East and South, rather than just to the North and West. And so, I spent a chunk of the mid-2000s not just working on bilateral issues with those countries, but running around to regional seminars on roads and power lines and electricity integration. We had a specially appointed Ambassador for regional integration, a guy named Bob Deutsch, terrific U.S. foreign service officer, who had been in Accra as the DCM. Richard Boucher, who was the then assistant secretary, was going to things in Istanbul. We were working with the ADB and with the World Bank on some of these things. Among other things, we inaugurated the first U.S.-Japan and U.S.-Korea consultations on both Central Asia and South Asia. Those Japan consultations were not just foreign ministry to foreign ministry, but included export-financing arms, the Japan Bank for International Cooperation, JICA, the aid agency, and so on.

Now, why am I telling you this? I’m not telling you this to relive my years of flying off to Tajikistan in the mid-2000s. I’m telling you this because I want you to notice the date. In the mid-2000s, this was years, nearly a decade, before China announced the Belt and Road and announced the launch of the Asian Infrastructure Investment Bank. And, that context is important because I think having been banging on about Asian connectivity for a decade or more, people thought I was a crank, nobody ever paid any attention to any of us who talked about this stuff, including Condi and people who worked on this, until China announced the Belt and Road, and then in a very reactive way, particularly in this town but frankly all over Asia, people said oh, my my God, China has this new big strategic initiative, how are we going to react to this, as if connectivity in Asia had been invented in China, invented in 2013, and like Athena from Zeus’ head, had sprung from the head of President Xi Jinping.

So, what I want to tell you by way of background is that is not the case. In fact, this idea of connectivity through infrastructure, through changes of direction of trade, direct investment, has a history in regions like Central Asia that predates the Belt and Road, and is not just a China story. If we’re going to talk about this strategically and politically, that context is important because it gets you into competitive connectivity but also the question of coordination that you talked about.

So, let me do that with that as background in three bites. First, as I just implied, I want to back up and talk about the context of some of this a little bit. Second, I want to come back to China, and put China into the picture, and talk a little bit about what Chinese money means for some countries individually, without over-generalizing. Third, I want to put the U.S. and Japan a little bit into the picture and talk a little bit prescriptively about what we can and cannot do with and around China.

So first, again, focusing on Asia and connectivity a little bit. It’s interesting, the United States has three separate foreign policies on Asia. There is kind of East Asia policy, which increasingly is about security balancing with China, as Dave notes. You’re giving me the thumbs up. All right. South Asia, which has been dominated by the India/Pakistan dynamic, and then Central Asia, which until this reorganization in the mid-2000s wasn’t Asia at all, it was kind of Russia. I remember Condi saying to me I want you to put the Asia back into Central Asia when you do this job. In that context, it’s easy to forget that for most of its history, Asia was in fact an astonishingly interconnected place with continental trade routes, maritime traders, plying the waterways. India, which eventually was disconnected and connected more to the British imperial metropole, you had Indian traders plying waterways around Southeast Asia. There are traces of that; Indonesia, Indo-China, in that history. That set of traditional patterns was
disrupted for a variety of reasons, many of which had to do with the economics of maritime versus continental trade. Some of which had to do with the arrival of the British. Some of it had to do with the arrival of the Russians in Central Asia. Chinese retreat from western borderlands, and so on.

I think part of what we’re getting at with this topic and discussions of this is not just China’s reemergence and the role of Chinese money, but the reconnection of desperate parts of Asia through investment and infrastructure along the lines that if you pull the thread out a few decades, will begin to restore some of the patterns that look more like the historical norm and less like the anomaly of the last few hundred years. Now, to see that, it’s important as I said not to conflate connectivity with just a China story, because there are other players in this, and it’s about the actions and choices of many Asian countries, not just China. But then second, it’s important not to conflate it just with infrastructure, which is what when people talk about the Belt and Road, they talk about.

If you think about this as David was implying in his comments in several baskets, infrastructure is one, direction of trade is another, non-infrastructure related capital flows and investment is a third, and then pacts, standards, technical agreements, trade agreements, and so on, is a fourth. If you think about it across multiple baskets, you can begin to see the way patterns are changing and historical patterns are beginning to reemerge. Let’s just take Central Asia as an example. When I went into the State Department, circa 2000-2001, with the Bush Administration, China constituted less than four percent of Central Asia’s trade, about 3.9 percent in terms of aggregate trade. Russia was about 27 percent, 26 pointsomething. By the time I left in 2009, the Chinese share had quadrupled to about 16 or 17 percent, while the Russian share, the Russians being the dominant quasi-imperial power in the region, had shrunk by a quarter to just around 20 percent. That was almost a decade ago.

Since then, the lines have actually crossed. If you look country by country, which is what you have to do if you want to see what this begins to mean, you can see how this has really changed. Kyrgyzstan, China 48 percent of Kyrgyz trade. Russia, down to 15. Tajikistan, China 36 percent. Russia down to 15, again. Turkmenistan, largely because of resource extraction, China 43 percent, Russia, a measly 6 percent of Turkmenistan’s trade, not that Turkmenistan has a huge trade volume, but I’m trying to make a point about the countries. Uzbekistan, roughly even, 19/16, but China again, a trajectory going like this, and Korea, by the way, around 10 percent of Uzbekistan’s trade, which comes back to my point about thinking about other players in this picture, and on and on.

Does this have strategic and political implications? Obviously, because in a region like Central Asia and in countries like this, Tajikistan is like the 16th or 17th poorest countries in the world, the arrival of a new economic player has the potential to create new sources of leverage, but also to empower a new stratum of elites that are tied to a new set of trading relationships, and to disempower a set of elites that were more tied to another set of trading relationships. I would argue that in certain instances, in many countries around Asia, that has been meaningful. Now, that is not just a China story. We often talk about the Belt and Road, we say oh, China is driving infrastructure development in Asia. Well, India, that’s more of a Japanese story than a Chinese story. The big capital projects in India, the Delhi metro, the Mumbai Delhi Industrial Corridor, high speed rail for Indian railways. This is largely Japanese financed, not Chinese financed. While China is now India’s largest trading partner in goods, and there is a lot of talk in India about Chinese money and infrastructure construction, this is still from my perspective largely a Japan story. India is a pretty big Asian economy. If you want to talk about infrastructure development in Asia, let’s not just talk about China, let’s put Japan into this picture.

Now, let’s look at trade, it’s a consumer story. Back to Central Asia. Uzbekistan, something like 7 or 8 out of every 10 cars in Tashkent, which is the Uzbek capital, they are Korean. Every consumer brand in India is either Korean or Japanese. Flat panel displays, washing machines, televisions, you name it, Korea/Japan. In large swaths of Asia, American capital is not part of this picture at all. It’s an Asian story, not a Chinese story, an Asian story, with China as a big part of that.

Now, you can pick this apart and you can say well, these are small individual stories, they’re
discrete stories; all of that is true, but what I would argue to you is in time and taken together, these stories will cumulate into a picture in which capital flows among Asian countries, direction of trade, infrastructure construction, investment, if you look across those various baskets before you even get to the issue of agreements and pacts, Asians collectively will be remaking their region in ways that the United States, as a power that is across a sea, ought to be thinking about this. It’s going to change the region in a lot of ways that we have not been accustomed to in the post-1945 period. This goes for India, too, which I would encourage you to put in this picture.

I’m supposed to talk about the strategic implications of China’s economic statecraft. The India and Asia story largely flips it. It’s a story of people interested in security balancing with China who have become very interested in this other large continental sized country, and the economics have really lagged, which is why China is what, 12.5-13 percent of ASEAN trade, but India is now at like 2.5-3, because India doesn’t make stuff, so it’s not integrated into those supply and production chains that are the backbone of the Asian economics. So, the economics lags, but India is becoming more a part of that Southeast Asian story, as Owen and I were talking about before, partly because of security drivers. I think as India develops and reforms, in time, it will be part of this story as well. If you contextualize it that way, what I want you to take away is Asia connected, not just the China story. That hints at some of what I want to say prescriptively about the United States and Japan for that matter.

So, now let’s put China a little more directly into the picture. All of that said, China is, I think, changing the balance of forces around its periphery in some interesting and important ways. First, just because it does things that the United States doesn’t do, and other countries don’t do. It has a model of finance that there aren’t a lot of competitive offerings. Second, because of its geographic contiguousness to other parts of Asia, which is just a reality, you can’t fight geography, can’t build a bridge from Tajikistan to California, for instance, but you can build a road to China. I think the way to think about this is in a couple of discrete bites. First is the question of the timeline. This goes back to my point about the Belt and Road in 2013. Ironically, many of the most important Chinese infrastructure and capital projects around Asia predated the Belt and Road.

So, to those who just started focusing on this, when China announced the Belt and Road, even the China story is not a Belt and Road story. Oil from Kazakhstan, gas from Turkmenistan, those negotiations and those pipes are not Belt and Road pipes, these predate that. In the mid-2000s, we were already beginning to see the Chinese running around this region, where the Russians had really had a hammerlock, kind of a monopsony, for instance, on Turkmenistan’s gas. What had been a story about a single point of transit northward through Russia, China represented greater complexity, diversity, and I would add, therefore, bargaining power for some of the countries in question. It’s been a long time since I did this stuff, but in the mid-2000s, when I was working on Central Asia, for instance, I think the Russians paid Turkmenistan something like $130 per 1,000 cubic meters for their gas. By the way, had pretty much a hammerlock. That was the story of Turkmenistan, was the Russian dominance as the demand relationship. The Russians used to use Turkmenistan gas for domestic customers and then used their gas to export to Europe, at higher prices, by the way.

China’s arrival in the first instance represented some bargaining power for Turkmenistan vis-à-vis Moscow. That’s appealing, but really changed the score. And so, what we have now is rather than talking about dependence on Russia, we are really talking now about dependence on China, because that relationship is a lot more important to a country like Turkmenistan than it is to China. Does China need the gas? Sure. But to get to the projection, what is the projection, 400 or 420 bcm of gas by 2030? I don’t know what it is, but if you want to get to 350/400/420 bcm, you need to just assemble pots, there is X bcm from Turkmenistan, this from Myanmar, this domestically. So, that gas is important but it’s not as important in the overall picture as it is for the supply country. So, we have the potential when we talk about strategic and political implications, for a country like that to swap dependence on one external country to another, the other being China, and that’s important, and I would argue has some strategic implications.
The second issue as I said is the issue of gravity, because you can’t fight gravity. It’s tough to fight geographic gravity, and it’s tough to fight economic gravity, right? China is the number two economy by nominal GDP. It’s the number one manufacturer, the number one trader, even with what is happening to the reserves, it is still sitting on a large pot of reserves, and lots of money on corporate balance sheets, including SOEs, that it wants to plow into higher yielding direct investments, including around its periphery. And that being the case, as David said, that money is going to go somewhere, and much of that is going to go to developing countries that sometimes have weaker states and less capacity to resist the terms or to mediate the terms, and in any case, for a country like the United States that is not geographically contiguous, that gives China a role that we simply will never have. The fact is China is geographically contiguous to every other part of Asia. The United States is not. Japan is not. Korea is not. India is not. They are contiguous with Northeast Asia, Southeast Asia, Central Asia, and South Asia. Maritime continental. So, you put all that together, it’s tough to fight geography. They are going to be there and they’re going to play a role.

The third thing I would say is my impression is there is not a uniform Chinese model. If you look at Africa, if we go beyond Asia, Chinese firms have done very well and dominate in some sectors, but not in others. Once more, the strength or weakness of the state comparatively says a lot about the nature of the interaction with China. So, generally speaking, the stronger the state, it’s intuitive, the stronger the state, the greater bargaining power they have vis-à-vis the Chinese in discussing terms. The weaker the state, the less bargaining power they have, and we see that in Asia as well. If we want to talk about political and strategic implications, one thing we have to look at is the comparative strength or weakness of the state. If you’re talking about Indonesia or India, it’s different than talking about certain other countries around the region.

Last point. We should remember that Chinese investment has produced a backlash in a number of countries, including around its periphery. We shouldn’t overgeneralize about it because there are different kinds of backlash in different countries. One, let’s call it the nationalist backlash. Where do we see this? Places like Kazakhstan, which a couple of years ago was debating a new land law that was designed to allow greater equity in land ownership and raise the specter for many people in that country of foreign ownership of land, which is a kind of third rail of politics in Kazakhstan.

So, here in a country that is not known for social and political protests has suddenly had people in the streets in cities like Aktobe, Semey, and Atyrau, over the question of Chinese ownership of land. So, yes, the money is appealing, but a nationalist backlash. Same around labor issues, not just land. Kyrgyzstan, as China relocates some production to Kyrgyzstan, which is largely a political project, not an economic one, but to start producing and manufacturing some things. In Kyrgyzstan, there have been debates between the two governments about the scope and size of the Chinese labor pool, how much will be imported labor, how much will be Kyrgyz labor. We see that in other countries, Sri Lanka is an example that has been in the news lately, although that one is ironic because the former president, who encouraged all this Chinese investment, is now ironically in the position of trying to leverage that protest against it, partly as a political tactic in Sri Lanka.

The second kind of backlash is a security backlash. Take Australia, where the Australia equivalent of CFIUS just denied an investment by State Grid into Ausgrid, which is the new South Wales power grid. We are starting to see these kinds of debates here in the United States, where the concept of security may or may not be becoming more elastic, and in Europe as well. Third, there is the competitiveness backlash. What does China mean for domestic competitiveness? You see this in a lot of countries, but you also see this because of the nature and content of trade. Take a country like India, for instance. We have a trade imbalance, but it’s partly an imbalance in goods, with a lot of value added coming from China into India and resources going from India to China, and that has political implications in a country like India. So, integration, not just a China story. China, not just a simple story, and not just a one-dimensional story. Last, what does that mean for us.
My view, and we can talk about this, Richard, when we get up here, is that the United States in particular, because I’m American, Japan much less so, has been entirely too reactive and defensive about all this, when it should be proactive. And as I said, stepping back and thinking how it wants to play if at all in the broader set of trends that I’m talking about. So that U.S. strategy and policy, for example, is not just guided by a sense that China is doing things to which we need to respond, but rather we’re thinking in a proactive way about what we can offer, how we want to play or not, and who are various partners might be, potentially including China, but I would argue by no means limited to China, as my comment about U.S.-Japan consultation and coordination on Central Asia was meant to imply.

The AIIB, since you guys raised it, is an example in my book of what not to do. First, because the outcome was not the one the U.S. would have desired, the United States, looking symbolically and in reality quite isolated from some of its closest partners in Asia and Europe. Second, because the United States didn’t offer a distinctively American model of this. There was an international financial institution, an ADB model. There is not a distinctively American model. There are many fights with China to come over standards and arrangements. So, if we are going to have fights, let’s have them in places where the U.S. brings something unique and distinctive to the table. This, I would argue, is not such an area. More importantly, I think the lesson I take from the AIIB is the United States should never force its closest partners to choose between the United States and China on things that are not a vital security interest. If it’s a vital security interest, that’s one thing. On a non-vital, non-security interest, which for many of them, infrastructure construction is not, we can see the result of that, and implying there is some choice to be made doesn’t always go to the benefit of the United States, as it did not in this instance.

The U.S. also needs to think about when Chinese initiatives supplement as opposed to supplant existing mechanisms or the mechanisms that the U.S. would prefer, which may or may not exist. So, in the instance of a trade agreement, does it supplement, does it supplant? An infrastructure bank, did that supplement or supplant? To listen to David, this was not a supplanting of the ADB and the existing architecture, it was a supplement, one that needs to be worked through and will evolve over time, but not necessarily some kind of existential challenge to the existing order. There may be other existential challenges, but this wasn’t an example of one. Dealing with instances like this requires, I think, a degree of strategic and tactical coherence that the United States has thus far not really displayed.

To make that real for you, let me give you an example from the Obama administration’s first term, and then the AIIB example from the Obama administration’s second term. In the first term, the administration -- I was in the Bush administration, so I wasn’t party to any of these discussions, but based on impressions -- in the first term, the administration had a debate about what to do about something called the East Asia Summit, which was the Pan-Asian group that did not include the United States. If you remember some of the debates around the EAS at the time, the argument was made by some, and ultimately many in the United States, that U.S. exclusion in and of itself was a challenge to U.S. interests in the Pacific, and was not ultimately in the American interest. So, what was the response to that Pan-Asian grouping that did not include the United States? It was to encourage American allies to join the East Asia Summit, like Australia and New Zealand, and to sign the ASEAN Treaty, which was a prerequisite to joining, and ultimately, to join the East Asia Summit itself, because absence, it was argued, in itself was a threat to American interests.

Now, fast forward to the second term. Along comes the AIIB, another Pan-Asian group. The United States weighing whether it is in or out. Here, the argument appears to have been that the U.S. interests were better served by absence than by presence. So, really stands the debate about the first one on its head. The U.S. actually discouraged some of its allies from joining and has not joined itself. Why in the first instance was absence a threat to American interests and the second absence was somehow in the American interest? In fact, I would argue that in many ways, the East Asia Summit really didn’t do much, it was kind of a high-level talk shop, where the AIIB, the second instance, here is an organization that has the potential to dispense billions of dollars in project finance around Asia, including to countries that the United States has a very strong and deep strategic equity in. I’m not going to argue this way or the other,
but I would just say it doesn’t compute for me if you’re thinking in terms of strategic and tactical coherence why the argument from 2009 to 2012-2013 was for presence, and then later, it was for absence. One of you may want to make that argument, but I just think there needs to be greater coherence and consistency to the way the United States thinks about what I think will be the inevitability of Pan-Asian formations, persisting and cohering, regardless of American preferences, and other stuff as the United States takes itself out of the equation, as it appears to be the case in TPP, for example.

That’s going to be important because as Asia becomes more interconnected in the way I described at the very beginning, the United States risks becoming progressively less relevant in large chunks of this region over time. In Central Asia, mostly irrelevant, particularly in the economics base. South Asia minus India, with the exception of India, broadly irrelevant. Mainland Southeast Asia and countries like Thailand where the United States is actually taking itself out of the equation for political reasons. You pull this thread over time, and Asia that is more Asian than Asia Pacific, more continental than subcontinental, as East and South Asia become more interconnected, strategically, not just economically, and more Central Asian than Eurasian. In other words, the more integrated space, is one in which in absolute terms the United States will still remain important, particularly in East Asia as a security balancer, because China has scared its neighbors silly. In economic terms, the United States has the potential to fade, even in East Asia.

If you look at trade relations, U.S. trade with almost every country in East Asia is going up in absolute terms, but declining in relative terms. Is that a threat? No, not necessarily, but it does change the role the United States has played in this part of the world over time. If the United States fades progressively from large chunks of this region, to me, back to what you asked me to focus on, that certainly has strategic and political implications for the United States. The United States can’t just bring certain presumptions about its innate relevance it has had in post-1945 but especially in the post-1960s and then fast-forward, the post-Cold War period to its role in the region, and it needs to be more active, less reactive, and think more broadly about partnerships in the region.

That brings me to the U.S. and Japan. It has long seemed to me that in regions like Central Asia or South Asia where Japan hits all of the buckets, it has strategic and diplomatic presence, it has a project finance presence through JPIC, it has an aid presence through JICA. There are very few countries that are potentially U.S. partners that hit multiple baskets, project finance, aid, strategic and political, trade, and have corporate investment. That is the kind of partner the U.S. should be looking for in a lot of these instances, and particularly in countries like Thailand where the United States at the political level cannot be a player in the way it was, for instance, in the pre-coup period. The United States has all the more incentive to look to Japan to be in the lead because it is less unburdened by some of those concerns in its foreign policy, toward that particular country, certainly. To look to Japan to take the lead in an equal partnership toward shared strategic objectives in these parts of the world, and in part which is to diversify the range of partners that these countries have. I mentioned we had inaugurated consultations between the U.S. and Japan on Central and South Asia in the mid-2000s. To the extent those had happened before, they had always been foreign ministry to foreign ministry consultations. It was the State Department. We added in JICA, we added in JPEC, we added in METI, we brought in TDA, we brought in USAID, and this became an integrated government-wide consultation. We didn’t do it a lot of times, and I went on to another job. The point is that’s the way to think about various dimensions of national power, and we could do the same thing with other countries. We did with Korea for Central Asia, for example. As I said when I talked about Korea, Korea actually has a role to play in that part of the world.

The last thing I would say is particularly in regions where the United States has less relevance through its private sector, the U.S. ought to find ways to piggyback off existing structures rather than trying to create things wholesale. In East Asia, this is less of an issue, but in South Asia, there are lots of interesting possibilities, and in Central Asia, there are existing structures. For example, when I was in the government, there was something called the Central Asia Regional Economic Cooperation Program, that David, you may remember from your days at the bank, the CAREC Program. It has 8, 9, or 10 members

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now, most of the key countries in Central Asia, China is in, Azerbaijan is in. It has six multilateral development banks, World Bank, EBRD, ADB, the Islamic Development Bank, and maybe IMF and one other. So, there’s an example of a structure that exists and has a lot of the right countries and it already has many of the financing arms in it. Rather than trying to create something de novo, this goes back to what I mean by reactive, you can imagine the U.S. government having lots of interagency meetings about the Belt and Road and what do we do that would be relevant in Central Asia, forget that.

There are existing structures that the U.S. can piggyback on. At that time, for instance, we came up with an idea we called “CAREC Plus Three” The Plus Three being the United States, Japan, and the European Union, the three big market economies who could piggyback onto an existing structure and create a Plus Three ministerial and a Plus Three financing arms discussion, and in any event the U.S. and Japan were very enthused about this, and it was the Europeans that killed this idea, for reasons, some of which has to do with European relations with Russia at the time, some of which had to do with conflicting views within the Union, Europe always being complicated. But, the point is you don’t always have to create, sometimes you can look in creative ways to piggyback off existing things. I think the U.S. and Japan in particular bring a lot to the table within the Asian context and in the way they can be successful, and that includes public-private partnerships as well. Why don’t I stop there, and I hope that contextualizes this a little bit in a way that gives us something to chew on up here. Thanks. (Applause)

MR. SEGUCHI: Good morning. I’d like to introduce my view about Chinese economy from a little bit different angle. I visit China several times a year, and I often discuss this with my friend in the Chinese government. I’d like to introduce my view on the basis of the discussion of my friend in China. First of all, on the Chinese economy, the role of East Asian countries, China, Japan, and Korea. Please look at this figure. The bottom line, this is Korea, and the second one is Japan, and the red one is China. The black line is submission of those three countries. This is according to the IMF.

In 1980, the total amount of the three countries’ GDP, this is symbolic fact. Second, this is a share of each country’s GDP in Asia. China, Japan, Korea, those three countries share 78.5, almost 80 percent of the Asian economy, and only less than 10 percent by India, and 9.8 percent in the ASEAN five countries. So, Japan, Korea, and China is leading Asian economy. Those three countries have a leading role in the Asian economy. Many goods and services are exported from those countries to Asian countries, and the structure is relatively complicated.

Recently, Chinese companies also include their competitiveness or technology level, so many Japanese companies are supplying their parts to Chinese companies, and through Chinese companies’ exports, Japanese parts companies are also enjoying exports to ASEAN countries or India, and the many parts also imported from those countries. Relatively, high technology parts made in China, Korea, and Japan, and lower advanced technology parts are made in those ASEAN countries or India. Those lower technology parts are imported from those countries to China, Korea, and Japan. That is the division of labor.

This figure shows the role of Asia in the global economy. The red line is Asia, and the light blue line is North America, Canada and the United States, and EU is listed. Around 2010, the Asia economy started to service the other economic areas, a gap between Asia and other economic regions, is expanding. That is also an estimation by IMF. I think the role of Asia is more and more important in the global economy, and the core of Asian economy is China, Japan, and Korea. China, Japan, and Korea should take an important role or should coordinate with each other to contribute to that global economy.

The second sketch is this one. This shows the recent relationship between the United States and China. I think the economic relationship between the United States and China is similar to MAD, mutually assured destruction. (Laughter) I’d like to show the difference between Japan in 1990 and China last year, because Japan in 1990 was kind of in a trade war with the United States. At that time, Japan was kind of a threat to the United States. At that time, the weight of GDP of Japan was 52 percent of the United States, now only 25 percent. China, last year, it was 61 percent, and according to the estimation by
the IMF, in 2020, it will reach 75 percent of the United States. Second line, weight of imports from each country, Japan and China, in GDP of USA. Imports from Japan was 1.5 percent in 1990, and last year, imports from China in USA weight GDP was 2.1 percent. Third line, weight of trade deficits of the United States from each country. In the case of Japan in 1990, only 0.6 percent, even on such a strong trade war, but last year, for China, 1.4 percent, much larger compared with Japan in 1990. This is a simple fact of macroeconomic statistics. Next line shows the future of the domestic market of Japan and China. Japan in 1990 and at present also, its domestic market is mostly closed. This is a feature of the Japanese domestic market. In the case of the Chinese domestic market, quite open.

In Japan, only McDonald’s or IBM or Coca-Cola, several American companies, succeeded in the Japanese domestic market, but others were very frustrated in Japanese domestic market, but in the case of the Chinese domestic market, please see a series of U.S. brand automobiles, including GM or Ford, now they are enjoying almost 3 million vehicle sales in last year. Walmart Supermarket surpassed 400 all over China, and other companies also enjoying, Pfizer or PNG, McDonalds, Starbucks, many American companies are enjoying huge sales and profits in the Chinese domestic market. Very different view in that feature of the domestic market.

Last line is posture toward USA. Japan, of course, we have strong U.S. alliance, U.S. -Japan alliance, so Japan is very friendly to the United States. But in the case of China, China is a very independent country. In some cases, China is hawkish against the United States, so if friction happens between the United States and China, it is far from Japan and the United States. I think from those facts, the risk of total destruction of economy is much higher between China and the United States than in the case of Japan and the United States. So, if those countries recognize that fact, and if those countries have some judgment, they will avoid very serious trade war. That is one view.

After I came to Washington, D.C. and I talked about this view with my good friends in Washington, D.C. and some of them told me there are some different ways of thinking. One is, recently, the United States’ companies have pessimistic views about Chinese domestic market, so they are not so interested in the future Chinese domestic market. This is one view. The main player is the government, so government can control total strategy of security, but in the case of a trade war, the main player is the private sector people or companies. The government cannot control very well those main players. This is a difficult factor to say about the United States and China. I hope both countries, both governments, and main players of people or companies keep calm judgment to the relation between China and the United States.

The third sketch is economic relationship between Japan and China. Specifically, Japanese companies understand in major cities with GDP per capita over $10,000, we can start to enjoy huge sales. This figure shows change of the Chinese population in major cities, which reached GDP per capita over $10,000 U.S. dollar. In the beginning of 2007, three cities reached that level, and every year, many cities reached that level because of the very rapid growth rate of the Chinese economy. In 2010, only 100 million people living in those cities, but in 2020, it will go up to 800 to 900 million in those cities. This is a potential market for Japanese corporations, so Japanese customers are increasing in proportion to those figures. More recently, we can see a surge in the Chinese tourists visiting Japan. In 2013, only 1.3 million Chinese people visited Japan, but last year, 6.4 million Chinese people enjoyed travel in Japan.

Probably in 2020 -- this January, that growth rate of Chinese tourism kept to around 30 percent, so such a tendency is continuing because that background of that is this figure, not exchange rate or some other test, change of test. Increase of middle-income people is very rapid. That is the base of those figures. So, more recently, when we visited China and meet with Japanese companies, they introduced to me there are five very vigorous industries in China, automobile, semiconductor, smartphone, liquid crystal, and e-commerce. Even with the Chinese economy declining slowly, but their sales in Chinese domestic market still keeps increasing.

From last autumn, Japanese companies started to increase their foreign direct investment to
China. After 4 years, in 2012, September, we had the Senkaku problem between Japan and China, and then many Japanese companies started to be very careful about foreign direct investment to China. But, last year, there were some industries which find a good market in Chinese domestic market, especially those five industries, even steel industry, they are facing excessive supply in the Chinese domestic market, but still they are enjoying the rising demand in China, so their operational level is very high.

After starting such a beginning, we continue to increase in three or four years, from 2001 to 2005, after 2005 also, and from 2009-2010 to 2012 also, so probably this tendency will continue to 2020. This is good for coordination between Japan and China, and including Korea, Korean companies. Many companies can enjoy the Chinese economy now. I agree with the total view of the former presenters, so coordination with China or coordination among China, Japan, or Korea, or the United States, European countries, is very important. If the coordination is going very well, we can enjoy such a big market together, but if a trade war between China and the United States happen, it will cause huge damage to the global economy because it will cause huge damage to Japan and Korea, and huge damage to Asian economy, and huge damage to the global economy. That is a fact surrounding the Chinese economy, so coordination is very important. I have finished my presentation. Thank you. (Applause)

DR. BUSH: I knew there would be great presentations, and you have all proved me right. We have some time for questions. Before we go to the audience, I wonder if there is a point that anybody on the panel would like to make as a comment about someone else’s presentation. Any burning issues? (No response) Okay. Let’s go to the audience. When I call on you, please wait for the mic, identify yourself, and then keep your questions short. The gentleman in the middle back there.

MR. TALLEY: Ian Talley, Wall Street Journal. I understand why it is good to presume that growth will continue at roughly six percent for China into the indefinite future, but there was no mention of the potential for a major decrease in that growth rate. That seems to be essential in presuming the nature of economic relations in the region. Since debt to GDP is over 200 percent, and it looks like other credit bubbles, can you address that? Secondly, the G20 is coming up next week, just given the nature of the fears or discussions in the global economy in the U.S. and China leadership, I wonder if you could touch upon that, please.

DR. BUSH: David?

DR. DOLLAR: So, on the first question, I did allude very briefly, but I admit it was quite briefly to the fact that there are risks building up in China, growth of investment has slowed down in the face of excess capacity. That’s natural. Consumption is growing quite well. Consumption is delivering about 4.5 percentage points in GDP growth, but they keep trying to push the growth rate up to about 6.5 through credit, through investment, in the face of excess capacity.

So, risks are building up, and I did at least briefly allude to the fact that you might have, you know, unruly capital outflow coming out of China. That would be difficult. So, you can imagine different types of financial problems that could emerge in China. I don’t think it’s the most likely scenario this year, but the risks keep building up and they’re not really addressing it very seriously.

Even if you get some kind of financial -- I hesitate to use the word “crisis,” -- but if you had some kind of serious financial problems in China and growth slowed down for a while, they still have good fundamentals that when you look out 10-20 years, you still expect the Chinese economy to be growing faster than the developed economies, faster than the world economy. I’m not sure I would stick to a 6 percent forecast if you are looking out a long period of time, but they certainly should be able to grow faster than the world economy, faster than the United States, for the foreseeable future.

DR. FEIGENBAUM: And they should get rid of the targets, they should get rid of these formal targets.

DR. DOLLAR: Yes.
DR. KAWAI: Just from a long-term perspective, I think the potential growth rate is going to decline, continue to decline. So, I don’t think a 6 percent growth rate indefinitely would be a sound assumption, but a potential growth rate is going to continue to decline, maybe this year, 6.5 percent, up until 2020, the average growth rate of 6.5 percent between 2010 and 2020 would be maintained. Beyond that, the growth rate is going to continue to decline to 5.6 percent, 5.5, 4.5 percent, as a trend. Still, as David says, that growth rate could be higher than the world average.

DR. BUSH: David Brown?

MR. BROWN: Thank you for very stimulating presentations. This is also a question about the impact of domestic economic developments in China on their overseas impact, and that is that it seems to be a debate, a very serious debate within China, about whether it should continue to open up the economy with many people around Xi Jinping being identified as people who favor that. On the other hand, there is very clearly a move to build up national, championed state-owned enterprises, and to do that, they have to close the domestic market to protect those companies while they do it. Could you speculate about how this debate is going to come out, and whether it will have any impact on China’s international role? Thank you.

MR. SEGUCHI: Recently, it has become clear that state-owned companies’ efficiency is much lower than private sector, so basically, the Chinese government is promoting that, restructuring or cutting down state-owned companies. Last year, a difficult project started, that is a merger between Wuhan Steel Company Group and Baoshang Steel Company Group. The purpose of that merger is not expansion of the state-owned company, but cutting down inefficient investment of Wuhan Steel Company.

If the government cuts down the Wuhan Steel Company, it will cause a financial crisis in the local area, or a huge unemployment problem in several local zones. The Chinese government is worrying about that. So they make the Baoshang Steel Group merge with Wuhan Steel Group, and probably, they will promote the cut down of Wuhan’s group, but there are so many resisting groups because Wuhan Group is supported by local government and local financial institutions, so that is a fight between the central government and local government, financial sector, and SOEs. We have to see the result of that fight between them. If it goes very well, it will become a model of the restructuring of the Chinese economy, but if it fails, they will face a more difficult situation in the future. So still very few people can predict what will happen in China.

DR. DOLLAR: Can I add just briefly, there are a lot of state enterprises also in service sectors, like financial services, telecom, logistics, social media, and in general, they’re profitable, but behind a protective wall, and they’re inefficient. So, I think it is in China’s interest to open up those sectors. A lot of the tension with the United States is around the fact that those sectors are closed, but you have huge resistance from incumbent state enterprise managers who are senior people in the Communist Party. I think this is a big struggle in China, and we have to see how it plays out. If they don’t open up those sectors, they can expect more trade tension with their partners, and they can expect the economy to slow down. I basically agree with what Masahiro was saying, and then you’re going to get a faster slow down if they’re not opening up those sectors of the economy.

DR. FEIGENBAUM: To David’s point, economic reform is not an intellectual problem. It is a political problem. In sector after sector, there are plenty of people in the Chinese government who understand perfectly well why market opening in certain sectors but also reform that allows the private sector to compete, and encourages competition in certain sectors where competition is insufficient would be a net positive for the Chinese economy over time. That is contested terrain, as you said in your question, and I think on state-owned enterprises on sectors like financial services, one line of debate is about domestic competition, and the other is about foreign competition, because if you think about the way Xi Jinping framed it, it was about reform and opening up.

My impression is there are plenty of people in China who are interested in reform but not so
interested in opening up. Opening up to domestic competition doesn’t necessarily mean you’re opening the economy to foreign competition, but if you want to be competitive in something like financial services, they need world class financial services firms, which are global firms, so they are going to need to open up over time. By the way, those will be largely Chinese, they will be staffed by Chinese, service with Chinese clients. I agree with David, they have every good reason, and their trading partners like the United States, are encouraging them to do that, but I don’t think until after the 19th we are really going to know, so it is unknowable until the politics sort out.

DR. BUSH: Mike on the aisle here, and then I’ll take a couple more.

MR. MOSETTIG: Hi, Mike Mossettig. I just want to raise something, in today’s headlines, the fight over the THAAD missiles. It seems like China now is much more ready to use economic tools as part of its coercive diplomacy, the threats against the Lotte Company, now they are telling Chinese tourists not to go to North Korea, the ban on cultural imports. Could you elaborate on that?

DR. BUSH: To my way of thinking, this is Chinese statecraft at its worse. I hold the view, and I have no evidence to back it up, that if in January of 2016, after North Korea did the missile test and then the nuclear test, if Xi Jinping had reached out very quickly to the president of South Korea and said we’re going to work together to bring this under control, the South Korean president would not have had as much incentive to ask for THAAD. Moreover, the source of the problem is not THAAD, it’s North Korea, so they are going after the wrong target here. The gentleman right over here.

MR. HURWITZ: Thank you very much for great presentations. My name is Elliott Hurwitz, I’m a former State Department, World Bank and intelligence community person. Would anyone on the panel like to talk about the South China Sea and the geopolitical impact of China’s economic diplomacy?

DR. BUSH: I think that’s a subject for another program.

DR. FEIGENBAUM: I will tell you an anecdote.

MR. HURWITZ: You mentioned strategy and tactics.

DR. FEIGENBAUM: Yes, but I meant it a little differently, but I will tell you an anecdote. On a trip to China not so long ago, I was there when the president of the Philippines, Rodrigo Duterte, was in town. We happened to be in the same hotel. So, I inadvertently wandered into his presser at one point. (Laughter) Because I had gotten on the wrong elevator, and instead of going up, I was going down. The Chinese security guards are glaring at me, and I kind of sidle off to the side.

I’m standing next to a couple of his guys, and so I lean over and I say, so, how’s it going? (Laughter) His guy says, going great, it’s going really well, the only question is are they going to give us our railway, that would be really great. I said well, you know, don’t sell yourself cheap because you can probably get it through the Belt and Road at like 2 percent, low financing, you can get it this other way, don’t trade. (Laughter) I do think there’s an example, the Philippines is an example of how we need to be careful about our presumptions, and to your point about THAAD, where economics and security have been in collision across Asia, with China as the instigator of much of the collision. Countries that are economically integrating with China, but nonetheless nurture these security fears. This tension between economic integration and security fragmentation is going to play out over time in a lot of countries, including the countries around the South China Sea that are claimants, but have growing economic relationships with China. As you see in the Philippines, that balance can shift over time, but if it all comes down to a railway and low financing, then boy, that has big strategic implications.

DR. KAWAI: Sorry, just one intervention. This South China Sea issue gives us some doubt as to whether China wants to accept the existing international law, and work within that framework or not. So, the implication for economic issues could be quite huge. I think if rule of law, the respect of international framework, will be maintained by China or not is a big issue. So, from that perspective, we hope that the U.S., the new administration, will also work within the existing international arrangement. (Laughter)
Like the WTO principles. This South China Sea issue is a security issue but has tremendous spillover implications for economic issues.

MR. HURWITZ: Thank you very much.

DR. BUSH: The woman in the back, in the purple.

MS. BOURBON: Hi, my name is Contessa Bourbon from The New York Times. Thank you for this informative presentation. I’d like to ask the panelists, what is your recommendation to the current administration to balance economic power of China, and should the U.S. join the infrastructure bank or Silk Road development?

DR. BUSH: David?

DR. DOLLAR: Well, picking up on the last comment, I think it’s in the United States’ interest to strengthen the existing international institutions and encourage China, provide incentives for China to become more embedded, so I think it was a mistake for the United States to pull out of the Trans-Pacific Partnership. That is not fully global, but it’s 12 important economies. I think that was a mistake. I think relying on the World Trade Organization is smart to resolve trade disputes.

Actually, I started with the point that there are enormous needs for infrastructure in the developing world. We should be increasing the capital of the World Bank and all of the existing development banks, and yes, I think the United States should join AIIB and try to help that integrate into the existing system of multilateral banks.

DR. BUSH: But we would have to make a financial contribution to join, right?

DR. DOLLAR: Yes. The U.S. is the dominant player in the World Bank. That’s well known. If you double the capital of the World Bank, the U.S. would have to allocate a small amount of money, and it’s really hard to imagine Congress doing that, and you would leverage it enormously, so that is why I think it’s a smart move for the United States. We’re moving into a multi-polar world. We have to accept that. We are more likely to get along in that world if we have strong international institutions.

DR. FEIGENBAUM: If you think about why the U.S. had a leadership role in Asia in the post-war period, it’s because it was a provider of security related public goods in the form of alliances and carrier battle groups and fully deployed military presence and so on; all the things Abe Denmark worked on. But also because it was a provider of economic related public goods and other benefits in the form of first being the demand, choice of demand, on which Asia’s exporting economies could power their way to prosperity, but also being a leader on regional and global trade liberalization.

If I project out forward, there is no basis for collective security in the Pacific until China and Japan in the first instance have a Franco-German moment, but also some of the big outstanding residual security issues are resolved. Let me say that again. There is no basis for collective security in the Pacific. Having said that, the U.S. was, is, and as far as the eye can see, for every country except China, going to continue to be an important provider of security related public goods.

That then brings us to the economic question, and there, the U.S. role 10 to 15 years hence for the reasons David said, is going to change compared to the 1960s, 1970s, 1980s. We are still a big source of demand, but that inter-Asian trade is going to change in relative terms. So, to the extent to that the United States is not a leader on the trade and investment liberalization, but about rule setting and standard setting and norm setting, the more the role the U.S. has played in the region and that has facilitated and enabled American leadership will change in ways that I think are amicable to U.S. interests over time. That’s not just about TPP, because to me TPP was the right answer but often to a framing of the wrong question.

If you ask, as many people do, what is the economic component of the so-called “rebalance to Asia,” which struck many people as too military centric a few years ago, oh, TPP, that is one way to ask the question and arrive at what many of us think was the right answer. If you ask the question differently.
and you said the United States has an interest in an open market oriented small liberal economic order in Asia, how will we achieve that, then by that standard, TPP was a not necessarily sufficient condition of that, you would need other tools - bilateral investment treaty with China to open its market. Bilateral investment treaty with India, public-private infrastructure partnerships. I think TPP is done for the U.S., so let’s back up from that and ask the other question, what are the tools the United States has, and the administration has articulated some. Secretary Ross has talked about FTA, bilateral FTAs. There are private/public infrastructure partnerships. There are other tools. The toolkit may change, but let’s not frame the debate all about TPP. Let’s think about the toolkit to help answer that question. If the Administration does that, I think it can come up with some pretty good answers to that.

DR. BUSH: Kawai-san, if the United States found a way to join AIIB, would Japan find a way?

DR. KAWAI: Well, I think it’s very important for Prime Minister Abe and President Xi Jinping to come up with a friendly relationship between the two countries. Still political relationship remains very fragile. I think Japan needs to trust China because China has the largest say over how AIIB is run and how projects are selected. If the U.S. joins, the U.S. is not going to be the number one shareholder, but likely would be number two. There is a question whether the United States wants to join an international organization where the U.S. is number two. (Laughter) I am not sure. If the U.S. does, perhaps it will be easier for Japan to join, but still, the bilateral relationship between Japan and China would have to tremendously improve.

DR. BUSH: The gentleman right there who has been very patient. This will be the last question, I’m afraid.

MR. JONES: Bill Jones from Executive Intelligence Review. A Chinese scholar has said the Belt and Road is more a vision than a project. Obviously, a project is ongoing economically, a lot of investment. But I think he was accurate in that, too, to the extent that the Belt and Road, which has been extended to Latin America and to Africa, has created a tremendous amount of optimism, and the nature of the vision is that infrastructure investment will lead to development and help to eliminate poverty, and this now is on the agenda, and it seems to me this would be very much in the interest of the United States. Since China has opened the Belt and Road to all countries, it would seem that the United States would have an interest in joining it. The U.S. isn’t going to invest in Central Asia and Southeast Asia big time. We have enough problems here. We could expand the Belt and Road to the United States. Last night, Foreign Minister Wang Yi said we would be happy to see the U.S. economy improved, something to that extent. Why don’t we expand the Belt and Road here? China could invest in the United States. Now there is a discussion in China. Would that not be the ideal thing given all the trade problems that are going to come up, that if there was a possibility of China investing in the United States, that this would help create a working relationship between the two countries. If I may just add with Evan’s comments on the history, the first Belt and Road conference in China was 1996, not 2013. The first discussions that I know we had with the Chinese in 1993 on the issue already led to books written in Chinese on developing what was then called the “Eurasian Land Bridge, the New Silk Road.” It really predates 2000 as well, and because it is so close to China, I think historically it is obvious that is the case. Thank you.

DR. DOLLAR: I agree One Belt, One Road is really more a vision than a project. It really covers all of this Chinese investment. I like to joke that the road turned out to be Park Avenue in New York City, and the Waldorf Astoria is part of the One Belt, One Road. (Laughter) The U.S. is already the number one destination for Chinese overseas investment, if you leave aside Hong Kong. There is a lot of Chinese investment coming into the U.S. There is an issue in that there is much less U.S. investment going in the other direction. We talked a little bit about the fact that China remains relatively closed, so that’s an issue for the United States and for the U.S. business community, that China itself remains relatively closed. The U.S. can take advantage of some of this Chinese financing, and it is, but I think the idea that China is going to play a big role in developing the infrastructure of the United States, I’m skeptical about that. There are plenty of sources of financing. The U.S. can borrow at very low terms, so there are plenty of...
sources of financing. You’re not going to see Chinese construction companies coming in and operating in the United States. I think that’s not realistic. I don’t really see what the comparative advantage is of China doing infrastructure projects in the U.S., but we have seen some examples, I just don’t expect it to be a big phenomenon.

DR. BUSH: Thank you very much. We have come to the end of our time. Thank you for your attention, and please join me in thanking our four terrific panelists. (Applause)
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