

THE BROOKINGS INSTITUTION  
BROOKINGS CAFETERIA: US-China competition in global development  
Friday, September 06, 2019

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(Music)

DEWS: Welcome to the Brookings Cafeteria, the podcast about ideas and the experts who have them. I am Fred Dews. This is the second in a two-part series of episodes from the Brookings-Blum Roundtable, an annual forum for global leaders, entrepreneurs, and policy practitioners to discuss innovative ideas and to pursue initiatives to alleviate global poverty.

My colleague Merrell Tuck-Primdahl, Director of Communications for the Global Economy and Development program here at Brookings was at the roundtable at Aspen, Colorado to talk with some of the participants and produce these episodes. In the last episode, she facilitated a conversation about the role of international development in US politics, with particular attention to the 2020 presidential race and she's joined me in the Brookings podcast studio again to present the rest of this episode.

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If you like the show, please go to Apple Podcasts and leave us a review, it helps others find it.  
Merrell, welcome back to the Brookings cafeteria.

TUCK-PRIMDAHL: Thank you, Fred.

DEWS: In case listeners missed it last time, can you explain again more about what the Brookings-Blum collaboration is all about?

TUCK-PRIMDAHL: Sure. The Brookings-Blum collaboration is about gathering experts who are passionate about international development and who come together to find new and innovative solutions to make sure that the momentum for solving things, like world poverty and tackling challenges like the application of artificial intelligence and a changing workforce, to the broader world and to countries that are less fortunate than the United States all get together and share ideas in a space where there is a bit of freedom and to have some new ideas for solving some of these big problems in the

world.

DEWS: Now I understand this is the 16<sup>th</sup> edition of the Brookings-Blum Roundtable, it just happened this past August and every year has its own theme. What was the theme from this year?

TUCK-PRIMDAHL: The theme this year was maintaining a bipartisan narrative on US global development and doing it in the context of the 2020 US presidential elections and beyond.

DEWS: So what can listeners expect in today's episode?

TUCK-PRIMDAHL: In today's episode, we are dealing with what could be one of the most consequential relationships in the world, which is the US-China relationship. So I am bringing together some fascinating experts with a cross section of perspectives to talk about what's happening in China, what's happening with the US position vis-à-vis China and are there entry points and opportunities for making that relationship more constructive?

DEWS: Merrell, I want to thank you for your collaboration on these episodes and the mic is yours.

TUCK-PRIMDAHL: This is Merrell Tuck-Primdahl, communications director for the global economy and development program. This segment focuses on coping with China and its rapid rise as both a global development donor and as an economic powerhouse.

We'll also touch on the US-China trade war. I'll start by asking some framing questions of Brookings senior fellow and interim vice president, Homi Kharas and Minxin Pei of Claremont McKenna college. Next, I'll turn Weijian Shan, an economist, financier, book author and chairman and CEO of the Pacific Alliance Group or PAG. Finally, we'll hear from Michael Froman, former US trade representative from 2013 to 2017 and currently vice chairman and president of strategic growth at MasterCard. Welcome to all of you. Homi, let me start with you. I know that prior to coming to Brookings, you worked on East Asia at the World Bank, shaping the institution's approach to the region and doing research and operational work in support of the East Asian Miracle. You also witnessed China's rise and

the country's remarkable track record in reducing poverty. Talk to me a little about that. So much has changed since then, what are your views about China's advancement? Today, China's a donor and a rising middle income country. Given that, why does the World Bank still lend there?

KHARAS: Thank you, Merrell. So, I thought I would remind people that when the World Bank wrote a report called the East Asia Miracle, it didn't actually mention China at all. The East Asia Miracle countries were countries -- South Korea, it was Hong Kong, it was Singapore, it was Taiwan, China -- but mainland China just wasn't really in the picture. So the emergence and growth of China is a relatively recent phenomenon and I remember that China didn't surpass a gross domestic product level of more than 1 trillion dollars until about 2001.

Today, China's economy is 12 trillion dollars at market exchange rates. So what economists talk sometimes about growth and growth rates and things like that, I think we forget the absolute dimensions. Imagine a country, a whole economy that started at a trillion dollars in 2001 and is today 12 trillion dollars, the second largest economy in the world.

So China's rise, not just in the 21<sup>st</sup> century but in two decades before then has been really an extraordinary event in economic development. It is the first very large country to achieve growth rates at that kind of level and actually has stood the development narrative on its head. It used to be thought that only small countries could grow at very rapid rates. China has shown that very large countries can as well and now they've been followed by India another very large country, again, posting very high levels of growth.

And as China grew, it has really drawn the whole rest of the region along with it so many of the Southeast Asian countries were starting to feel the effects of a major financial crisis in 1997 and 1998 and part of the explanation for why some of them were able to rebound was because they started to engage in building value chains with China. And through that and through engaging with the rest of the world in a very extensive open trade relationship, they've really been able to build prosperity for

themselves.

So today a lot of people talk about China's success as being the fact that they have brought hundreds of millions of people out of poverty. That's absolutely true but I think that something that also needs to be emphasized is the fact that China has built the largest middle class in the world today in terms of the absolute numbers of people in the middle class.

No country in the world has more people in what we would call, by western standards, the middle class, than China. And this has now become part of a global phenomenon. It took the world roughly 150 years from something like 1820 to 1970 for the first billion people to become members of the middle class and they were largely in North America, in Europe and later on in Japan.

The second billion people, it took about 25 years. Now, thanks to China, Vietnam, India, other Southeast Asian countries, we are adding about 1 billion people to the global middle class every five or six years. That's an extraordinary emergence of a group of people for whom prosperity has become something that is to be aspired to and one of the things that draws as common between the issues that people in China face and people in the rest of the world face is that they all aspire to the same things.

They aspire to education and health for their children, economic opportunity, the ability to enjoy a good life and not to be scared of falling into poverty because that's what being middle class is all about. You're no longer scared that a spell of illness or sickness or of unemployment will drive you into poverty because you know you've got some safety nets there. And at the same time, it gives you the opportunity to aspire to continue to improve the livelihoods of yourself and your family.

So, China, has now more in common I would say with the rest of the world from that people centered point of view than is often commonly thought. And one reason why organizations like the World Bank and many other multilateral organizations continue to engage with China is because China is a very large and very heterogeneous country so at the same time as people think of it as being really successful, that's true along the coast. It's not so true in the interior provinces.

And so people say well the integration sometimes happens more between big cities than between countries, that's absolutely true. It's the Shanghais and the Po River delta and other places in China that are integrated with the rest of the world but the interior of China still is not integrated even within the Chinese economy and so many of the projects that are being done by international development agencies are designed to build the level of connectivity, the higher standards in terms of governance and government capabilities of some of those poorer provinces in the region. And with that, I think there is a hope that the benefits of Chinese growth will be more evenly shared across this very large landmass in this place where the standards of living of people differ so massively, depending on where you happen to be born.

TUCK-PRIMDAHL: Homi, what an interesting description of the Asia region and of China's role in it. What I want to turn now to is Minxin Pei. You wrote a fascinating brief on the international development cooperation and the age of US-China strategic rivalry. This is a serious issue we are seeing in the headlines every day. How big do you think the risks are related to an escalation?

Will the rivalry between the two countries turn into something like a cold war? Do you think the Belt and Road Initiative will live up to its expectations?

PEI: Thank you. The risks are real, large and growing. This is really very bad news for both China and the US and also for the developing world because both countries play a very important role in the development arena. Right now, with looking at the escalation with the trade war, if President Trump's threat of imposing 10 percent tariffs, 300 billion dollars' worth of Chinese imports really take place. But we are also looking at competition, if not arms race, in the traditional sense.

August 2<sup>nd</sup> marks the date of US withdrawal from the INF treaty, Intermediate Nuclear Forces treaty, which is a very important treaty during the Cold War era. If the US goes through with its plan to deploy intermediate range missiles in East Asia, targeting China, we are going to see obviously, a further escalation. So these are all the concerns we should have. But in terms of international development and

also in terms of potential cooperation between China and the US, it's not completely a bleak picture because the US-China strategic rivalry is quite different from the last Cold War. First, it's going to be geographically concentrated. That is, the area where they are going to compete most vigorously and most -- in a zero sum fashion would be East Asia, Southeast Asia because that's where China is seen as posing the biggest threat to American security interests. So what that means in Latin America and Africa, they are not going to be engaged in the same kind of rivalry. And that leaves open the possibilities of cooperation.

And then the point I wanted to make in terms of the potential cooperation is that while these two countries will engage in a rivalry, they are unlikely to allow that to contaminate the areas of development to where both see some kind of overlapping interest. For example, I simply don't see that the US and China will be hostile to each other to such an extent that they will preclude collaboration in a third country, especially in Africa in terms of education, healthcare environment or clean energy. They probably will compete in infrastructure projects such as the Belt and Road Initiative, which I will talk about.

And finally, I would say that while these two countries will continue to compete, they will learn something from the last Cold War because the last Cold War, if nothing else, did leave behind some valuable lessons. That is, you have to find a way to coexist in this world and I just don't think that the two countries will be so blinded by their antagonism towards each other as to ignore the other areas of potential cooperation.

Let me just say a few words about the Belt and Road Initiative. There were really two versions of the Belt and Road. One is what I call a caricature, popular press version which paints China as having a very devious unified long term coherent strategy to trap countries in debt, to connect these countries into some kind of China centric system, both for China's economic vantage and geopolitical benefits.

This is just one version, which unfortunately is the one that dominates headlines, most people

buy into. There is another version, which is the real world version which sees Belt and Road as incoherent as more or less as a slogan, rather than a real coherent project. It sees it as lacking fundamental economic rationale.

It sees it as fraud with corruption, ransacking, to China's disadvantage and also sees it as a highly risky project which might cause China hundreds of billions of dollars in the long term.

So this is the version I think we should pay more attention to because that's the version most people were knowledgeable about China and Belt and Road will tell you that this is actually what's happened.

TUCK-PRIMDAHL: Let me turn now to Shan. I want to hear a little bit more about how the cultural revolution shaped China's own economic trajectory. You, yourself were remarkably affected in the cultural revolution and its aftermath and you've written an amazing book, *Out of the Gobi: My Story of America and China* so I'd love to hear your viewpoint, both on what capitalism has meant to China but also on China's own relationship in the world and now both in terms of its own consumer market and in your own current role as a financier in the world?

SHAN: China started economic development, in a real sense, only about 40 years ago when China began the so called economic reforms and open door policy and prior to that, since the founding of the new people's republic in 1949 until about 1979. About 40 years ago, China was under essentially a (inaudible) economy and when I was growing up, China went through several periods of very traumatic experiences such as the great famine of 1960 to 1962 where millions of people starved to death and then the cultural revolution which threw the country into a chaos. People like myself were exiled into the countryside. I spent six years in the Gobi, working as basically a coolie, a hard laborer and at that time, the economic system was borrowed from the Soviet Union, a centrally planned economy but that economic system didn't produce any kind of prosperity and economic development.

It produced only poverty and we didn't even produce enough to feed ourselves. So I think after



Mao died, after the cultural revolution, the new leadership under Deng Xiaoping reflected upon the experiences of the prior 30 years and decided that the only way to save China, especially economically and politically for the ruling class as well is to move in the direction of the market, hence they came out with this economic reform policy coupled with open door policy allowing foreign trade and foreign investments and exchanges with foreign countries in terms of students, personnel -- and if you look at how China has developed in the past 40 years, in my view, it's really the success of the market economy. The triumph of the market economy.

China developed not because of some unique China model but because China has embraced market to such an extent that today, private sector accounts for about 2/3rds of the Chinese economy. I think the problem with the Chinese economic system today is the government remains too big. The state owned sector remains too big and what China needs to do to continue to drive growth is to engage in further structural reforms to downsize the state owned sector to move further into a consumer market in the private sector.

Now, we are a private equity investor. We manage about 30 billion dollars. We invest billions of dollars in China. We invest throughout Asia as well and our investments have been quite successful but if you look at our strategy, we stay away from manufacturing sectors, from industrial sectors, from export sectors where China has enormous overcapacity and we focus all of our investments in sectors which are related to private consumption and we have been successful making those investments and the Chinese market has developed to a stage where you can build very large scale operations. I'll give you an example.

We invested in a company just about five years ago by the name of China Music Corporation. At the time we invested, it was not a business. They only had copyrights, licensed and bought copyrights for music, covering lyrics, music and record labels, covering about 17 percent of the entire digital music market in China. But otherwise, they didn't have much of a business at all. We invested about 60 million

dollars. We became majority shareholders of that company and there was a time where it was possible to enforce copyrights, IP, in China.

We quickly grew that company and today it is in New York, on NASDAQ and it's market cap is about 25 billion dollars. Five years ago, 60 million dollars and today, 25 billion dollars. We have monthly active users of 800 million and that's the scale that you are talking about and I often say that the business model turns out to be very successful but if you take that business model to say, Singapore, you will not get anywhere because the population is too small. You will not be able to build a scaled business but in China, given the affordability that people have today, you can build a large scale business within a very short period of time and that shows to what extent the Chinese consumer market is taking shape.

TUCK-PRIMDAHL: That's fascinating and I will encourage our listeners to order your book on Amazon. *Out of the Gobi: My Story of America and China*. It's a remarkable book.

So now, Mike Froman, you had an interesting vantage point earlier on in the kind of trade relationship between the US and China and I am sure you must have also visited China and had a vantage point on how the United States approach to international trade has evolved since that time and also, perhaps some ideas about how the two largest economies could perhaps bury the hatchet soon so I'd love to hear from you.

FROMAN: Well thank you, and this has been a really interesting conversation to listen to and I'd like in some ways to respond to what the previous three said in answering your question because I think as Homi said, China is a terrific example, a very successful example of poverty alleviation over the last 40 years. And it really is quite remarkable the number of people that have been lifted out of poverty and the impact that it's also had on the region and other players in the region and its done that, as Shan said, largely through a movement towards more market oriented reforms although I think we would all agree that that movement is not yet complete, that there is still room to go, not just in the size of the

state owned sector but the role of the party in the private sector and the various policies that make it an imperfect market situation and that's a lot of what we see in the current dispute between the United States and China, are trying to address those imperfections in the system.

The fact that China is still quite protectionist, it creates an environment in which local players can succeed in part by keeping real international competition out, sometimes by subsidizing either inputs or financing by subsidizing exports, by creating opportunities and this goes to Minxin's comments about the Belt and Road Initiative, making sure that China has access to other markets, access to raw materials for inputs, access to other markets through infrastructure. There is very much a strategic element to that, even if it's not as conspiratorial as some people suggest it is and that you have your doubts about but I think what's really remarkable about China is that it does have a concerted strategy and whether it's Belt and Road or Asia infrastructure investment bank or the regional comprehensive economic partnership, it has a regional strategy defined broadly. A region that in some ways extends to Africa, extends to Europe and it has benefitted over the years and has been able to succeed because of a global, rules based system that the US, Europe and a few others have put in place after the second world war and have in some ways paid the dues for. There is always a sense that US would keep its market open in order to first glance allow Japan and then Europe to rebuild after the second world war. After that, to allow developing countries to export their ways towards becoming emerging markets and in China's case, very successfully.

China has been able to achieve these gains and poverty alleviation, been able to pursue this regional strategy because we created a system that allowed that. It was a benign international environment where they didn't have to worry about their security because we were providing the security umbrella for peace in the region. They were able to pursue strategies of prosperity while basically being a free rider on the system.

And I think what that led to, of course, in the US, was a sense of unfairness and a reaction to

that. That now that China, while still has a lot of poor people, is very much a global competitor, that China needed to play a more significant role in upholding the system. And we saw that in the 2008 period when the G20 emerged and the view was now the challenges of the international economic system are too large just for the G7, you needed to have powers as important as China and India and Brazil at the table. We saw that in 2009 with the Copenhagen conference on climate change where the wall between developing and developed countries broke down and there was a realization that China needed to make commitments to because otherwise we couldn't solve climate change and we are seeing it now around the trade side where the WTO is reached, an impasse where we are in this trade war, back and forth -- really over whether China is going to play a more significant positive role in the international community or not and I'd say so far, China has successfully gotten a seat at the table but has not yet started picking up the check and everyone is waiting to see whether China is willing to pick up the check.

The US, which has played this leadership role in the past has withdrawn a bit, has retreated and it's unclear whether Europe, Japan, Canada, others can really step up and take the US's place and that's really -- to me, the interesting development is if you look at the America first strategy, it's really about putting our national interest narrowly defined first, which is exactly what China has done for 40 years and the real question to me is whether we can afford to have two Chinas in the world, both of which are pursuing their national interest narrowly defined, neither of which are paying the dues necessary to maintain the health and welfare of the international system which has benefited them and others so enormously.

So that's a long answer to a question that I think whether we have a trade agreement this week or month or not, to me, that's not the issue. I think we have sort of gone beyond that. We are in a new period where we are in a more broadly competitive relationship going forward and it's not about how many soybeans China might buy or how many airplanes or things of that sort.

To me, it's really a question of whether the expectations that we in the west had that in opening relations with China in 1979 and allowing China into the WTO in 2000, whether China would ultimately become more like us, more like the international standards and play that role internationally as the second largest and someday the first largest economy or whether or not we are going to find ourselves decoupling, creating two different or at least two different sets of rules and standards and finding ourselves in a more ongoing conflictual environment, not necessarily another Cold War. I don't think it's heading towards that but a period of increased scratchiness for some period to come.

KHARAS: I heard you say that we are still waiting to see if China is willing to pick up the check but in many of the multilateral institutions that we have, that have been the guardians of this world spaced order, China has, in fact, tried to push hard to become a more influential shareholder and has indicated that it's quite prepared to pick up the check but many others have suggested they are not yet ready because an increase in China's role would imply a diminution of their role.

FROMAN: When I say pick up the check, it's not just money. It's whether or not they are willing to uphold the values of the international system and whether, for example, will the Belt and Road Initiative projects follow the same sort of prudential -- whether it's environmental, anti-corruption and transparency, debt levels and sustainable debt levels, those kinds of standards that have been the hallmark of the international system over the last seven years or so.

Now China rightfully says well we weren't there at the table in 1945, we didn't define these rules. Now that we are a major party, we may want to have a different set of rules. That's their sovereign right to do that but then don't expect the rest of the world to bail it out when they run into problems on debt. You can't load up a country full of debt and then expect the IMF with the US as one of the major shareholders and others to then come and bail it out, I think. So I think that's the challenge, it's not just the money. Take the WTO, a lot of what the WTO was about and the gap before it was the western institutions, the western countries, for lack of a better term, US and Europe, primarily, willing to

allow asymmetric access to their markets for the benefit of the rest of the world.

That's not something that they are willing to do anymore. We are not willing to do that in the US anymore because we have seen the reaction over the time and we don't see China being willing to play that kind of role as a steward of the international system.

TUCK-PRIMDAHL: Well thank you, gentlemen. This is a fascinating conversation. We know that the innovations happening in China are also going to continue to reshape the world and the hope is that both the United States and China can find some common ground and innovate together rather than be always in tension with one another, so thank you very much.

PEI: Thank you.

KHARAS: Thank you.

DEWS: The Brookings Cafeteria Podcast is the product of an amazing team of colleagues, starting with audio engineer, Gaston Reboredo and producer Chris McKenna.

Bill Finan, director of the Brookings institution press does the book interviews and Lizette Baylor and Eric Abalahin provide design and web support.

Finally, my thanks to Camilo Ramirez and Emily Horne for their guidance and support. The Brookings Cafeteria is brought to you by the Brookings podcast network which also produces Dollar and Sense, the current, and our events podcasts.

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