PART II

Partners and Competitors
China: between global responsibilities and internal transitions

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INTRODUCTION

China’s relations with the United States will be one of the most important, if not the single most important, relationships on the international stage in the coming decades. But there remain specific points of possible conflict and contention, the most noticeable of which are Taiwan and the skewed bilateral trade balance. Over these looms the broader issue of how the United States accommodates a re-emergent, increasingly competitive economic superpower, which China stands well placed to become before the end of the next decade. China’s support for restructuring the global financial system is one area where it will be pushing against key US interests, and where the current international economic crisis has left the United States less able to assert itself. Another is the potential conflict between the two for commodities in the coming years. Nevertheless, the dynamic of the relationship depends as much upon developments within China as on American strategy. China’s leadership realizes that overt conflict with the United States is in no one’s interest. But it also understands that the global system needs to be more representative of China’s importance, and that, in the years ahead, Chinese public opinion, which is becoming increasingly assertive, will not accept political elites that look as if they are selling China cheap.

The fact remains, however, that talk in the United States, China and beyond that the G2 (the United States and China) is now the only truly meaningful global partnership, rather than the G8 or the G20, will lack substance until China’s leaders show greater clarity on what role they want it to play on the world stage in the future. At the moment, there is little evidence that it wishes to assume a global leadership position. It remains preoccupied with issues of internal development and maintaining its own territorial integrity, something that was forcefully underlined by the explosion of violence in the North West Xinjiang Autonomous Region in July 2009. And its leadership will be preoccupied until 2012 with a crucial transition to a new, fifth generation of leaders.

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It has been widely noted that, in the first months of 2009, the administration of Barack Obama enjoyed a remarkably smooth initial period with the Chinese government. This bucks the trend for most previous administrations of having an initial testing period and then settling into more harmonious relations. Secretary of State Hillary Rodham Clinton paid an early, high-profile visit to Beijing where she declared that the key consideration was economic cooperation between the two countries, and that other matters, including contentious issues such as human rights, needed to be seen in that context. President Obama met President Hu Jintao at the G20 Forum in London in April 2009 and enjoyed wide-ranging and positive discussions. Both sides started to address the thorny issue of climate change and what sort of deal they could both live with after the UN Climate Change Conference in Copenhagen. Barack Obama is the first US president to have visited China within the first year of his presidency, something that was noted when he went to Beijing and Shanghai in late November 2009. And the Joint Statement issued as a result of this visit was one of the most complete and wide-ranging ever issued between the two countries.¹

Conflict is a remote and unlikely prospect. But China’s military build-up and future potential, its projection of military and political power into ever-increasing areas in the world where it is acquiring considerable strategically economic assets, and the fact that it looks likely to emerge from the current economic crisis faster, and in better shape, than any other major economy, all contain seeds for future bilateral tension. Dealing with these challenges of a rising China will be a key theme for the Obama administration. During his first year, the President showed extraordinary international ambition. With China, it is already clear that he will be seeking a historic concord on climate change and will attempt to forge a bilateral relationship with a new level of shared strategic aims. The question is just how far China, with its internal complexity, can go to meet him with these aspirations.

**China’s internal dynamics**

China is, by its economic size and the speed at which it is industrializing and developing, a global power. But it is a contradictory global power, and this makes it potentially both unstable and unpredictable. It is the world’s second largest economy (in purchasing power parity terms), and, as of 2009, the world’s largest exporter, and it has the largest foreign currency reserves. Over two decades of double-digit growth and massive investment have endowed large parts of the country, though far from all, with modern physical infrastructure. And, in the larger cities at least, an increasingly affluent, free-spending, property-owning middle class has emerged. But there are good arguments to show that the urbanization of China has been at the cost of its real entrepreneurial development.² The Chinese private sector thrived in the countryside in the 1980s. It has been controlled and, in some areas stifled, in the last decade of more urban, pro-state-sector growth.

For all the wealth creation of the last three decades, this is a country with
perhaps as many as 200 million profoundly impoverished people, whose suffering was highlighted in the earthquake in May 2008 in Sichuan. One US report has called this the world’s first ‘rich poor country’. Income inequality has grown rapidly in recent years, raising risks of social instability. Despite increased spending on health and education, social service provision is rudimentary. Public institutions are weak and, while rule of law is improving (created in effect from scratch since 1978), it is still patchy. Notwithstanding an authoritarian system, the capacity of the central government to implement policy in any of China’s 31 provinces or autonomous regions is often limited. The current leadership has put a lot of effort into dealing with corruption, and it inspired the current talk of ‘harmonious society’ and the attempt to implement more pro-poor policies, but corruption remains prevalent. All of these factors impede efficiency of government in China, eroding confidence and trust. As Premier Wen Jiabao has said, China’s greatest challenges, and the greatest threats to its stability, come from within. This needs to be factored into any discussion of its relations internationally.

Because of their fundamentally different political systems, and the different cultural values they espouse, the interaction between China and the United States will be the key global relationship in the coming decades given the continuation of the United States as the world’s superpower, whatever the extent of its relative decline, and the revival of China as a great power. It is clear from many statements by senior Chinese leaders that they see the United States alone as the key power for them to relate to in the coming years. The European Union only features in their world-view as a trade partner.

For the United States, the challenge of accommodating a new, dynamic, but sometimes hostile power, with its own global aspirations and ambitions, will be significant. China is likely to continue to pursue the largely cooperative attitude that was enshrined in the famous ‘24 character statement’ issued by Deng Xiaoping in the 1980s, in which he insisted that China be a biddable and positive member of the international community, seek to build relationships and friendships across the region, and build up its internal economic capacity, if it sees this as in the best interests of its stability and success. Both countries will want to avoid conflict, and conflict is, as noted, unlikely. But in two areas – economic competition and Taiwan – there is certain to be continuing tension and hard negotiation. This is the case even though, in the short term, the return of the long-ruling Kuomintang (KMT) to power after the 2008 elections in Taiwan has eased cross-Strait tensions considerably. Taiwan’s potential to throw up unexpected problems should not be understated. President Obama’s early decision to give Secretary of State Clinton ownership over policy towards Asia, and specifically China, means that he has avoided the long hiatus that occurred between the inauguration of the George W. Bush presidency and its decision of who had lead ownership over policy towards China. Secretary of State Clinton’s high profile means that she is taken seriously in China. Her upgrading of the Special Economic Dialogue to embrace strategic issues was also welcomed (see below), though some in the previous administration criticized it for conflating too many issues into one vehicle. Even so, it showed
that the administration was looking beyond just the economic relationship. In view of the complexity of the shared interests between the two countries, that is sensible. But will China be able to deliver on these expectations? This is the question addressed below.

THE HISTORICAL CONTEXT

Despite all the profound changes of the last four decades, the fundamental parameters of US relations with China are still those set by President Richard Nixon during his groundbreaking visit to China in 1972, a visit that predated the economic reforms after the death of Mao in 1976. Since these reforms started, the United States and China have largely sought mutual benefit, engagement and cooperation, but within boundaries. China has gained intellectual property and expertise from US investment in hi-tech industries, but American firms, like those of most other countries, have been careful to keep their most sensitive intellectual property to themselves, especially since Chinese firms have started to become international competitors. The general parameters that existed since the beginning of the rapprochement are unlikely to change without a major cause of disagreement or conflict. What is fundamentally different now is that, having constructed a major economy since 1978, there are increasing international concerns about China’s external impacts and growing expectations about the sort of ‘responsible’ role it should play in the global economic and political system.

Until the presidency of George H. W. Bush, surveys (inasmuch as they have been allowed) indicated that most Chinese looked up to and wanted to emulate the United States, regarding it as a model they wished to use in their development. Following the Tiananmen Square Massacre in June 1989 and again under George W. Bush, public opinion appears to have turned against the United States. The accidental bombing of the Chinese embassy in Belgrade by NATO during the Kosovo conflict in 1999 was another landmark in souring views. This is ironic because, in the mid-1970s, when his father was head of the US Liaison office, George W. Bush had lived in Beijing and could claim some understanding and knowledge of how China worked. However, a combination of international and bilateral events (the shooting down of a US spy plane over Hainan in early 2001 being the most striking) meant that, by the time of the terrorist attacks of 9/11, US–China relations were going through a particularly bad patch. President Bush seemed to be veering towards greater recognition of Taiwan and was keen to push China harder on human rights and trade issues. At a time when China was becoming increasingly open to the outside world, especially with its entry to the World Trade Organization (WTO) in 2001, Bush’s administration was in danger of going down as one of lost opportunity with China.

All of this was changed by 9/11, which had a considerable effect on the dynamics between China and the United States. China’s support for resolutions against Afghanistan at the UN led the United States to place one alleged Uighur secessionist group onto its terrorist list. There was also a reduction in lobbying
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on human rights issues. For China, disunity and instability are the ultimate bogeymen and are blamed for the most baleful periods of its history since 1850. Not wanting to see an unstable China, US policy has largely been sensitive to and cautiously supportive of the central government in its handling of restive areas in the west of China. Following this pattern, the Obama administration, like most Western governments, expressed concern about the July 2009 crack-down on violence in Xinjiang, but held back from stronger statements that could imply any desire to see China breaking apart. That would be a massive force for instability in the rest of the world.

MANAGING THE TRANSITION TO THE OBAMA PRESIDENCY

Hillary Clinton’s first visit to Asia as Secretary of State, in March 2009, included a high-profile meeting with Chinese leaders in Beijing and dispelled many immediate worries on the Chinese side. Historical Chinese unease with US Democratic administrations as compared to their Republican counterparts, along with a general lack of understanding of President Obama’s political instincts among Chinese officials during his campaign, were partly dispelled by Clinton’s clear signal that the United States viewed its relationship with China as critical for the region and for the world, and that China’s partnership in confronting problems in the global economic order was key. Perhaps most important, Clinton’s willingness to talk of the relationship in broad terms, rather than focusing, as had been feared in China, on narrower issues of human rights and political differences, went down well. That she was willing to declare this approach openly to the American public via an interview on the way to Beijing helped too.

The administration’s creation of a ‘Strategic and Economic Dialogue’ to replace the previous purely economic dialogue, the first meeting of which was held in Washington in late July 2009, backed up Clinton’s words with the institutional means to carry on this enhanced, broadened dialogue. Spats between submarines in the South China Sea (in what the United States claimed were international waters, and China claimed were in its territory) did not have much impact. Nor did the evidence of increasingly aggressive cyber-attacks from China, creating the need in Washington for a special office to deal with these threats (the United Kingdom has also followed suit). All of this good mood music was amplified when President Obama met President Hu for the first time (they had talked several times by telephone before their meeting) at the G20 in London in April 2009. Their agreement on the main strategies to deal with the global recession, with China even contributing US$40 billion for aid through the International Monetary Fund to developing countries, was a tangible outcome of this new partnership, especially their agreement, finally, over the treatment of tax havens after the raising of French concerns.

These positive steps do not negate the continuing potential for bilateral tensions. As the 2008 US National Intelligence Committee report Global Trends 2025: A Transformed World spelt out all too clearly, China’s growing role in the
global economy will push it into competition with the United States in other countries, especially in view of its major investments abroad and its continuing search for resources in areas like Africa or the Middle East. The American concern was once that China’s global role was too limited; now it is the reverse. Over the past decade, China has participated in international forums at almost every level, taken part in UN peacekeeping missions, played a more assertive role in the UN Security Council, and joined the WTO. But the United States, and the West in general, takes more notice of its involvement in countries such as Sudan. China buys around two-thirds of Sudan's oil, and has faced criticism for its support of the Sudanese government. In May 2007 China responded to the mounting criticism, appointing a highly respected diplomat, Liu Guijin, as its special envoy on Darfur, sending 3,000 peacekeeping troops from China to the region, and finally supporting a UN resolution on Sudan, albeit a softer version than had originally been proposed.

Nevertheless, China's actions are clearly motivated by a precise definition of its national interest. This definition revolves around the search for stability, which is based, in turn, upon the critical need for continued high rates of economic growth. Growth requires a peaceful international environment and, more specifically, increasing energy and raw material imports. But its booming demand for oil pushes China into long-term equity deals with a range of African and Middle Eastern countries, which leads, at times, to competition with US and other Western oil companies and, at others, to propping up authoritarian regimes. China has shown itself willing to transfer technology and to supply regimes in countries such as Sudan, Zimbabwe and Nigeria with military hardware (despite its stated support for non-proliferation of conventional and nuclear weapons) to curry favour with their leaderships.

In the specific area of relations with the authoritarian and nuclear-armed Democratic People’s Republic of Korea (DPRK), China has a key role to play, both as a neighbouring country and as a major conduit of energy supplies. The importance of its role has been brought into sharp relief by the series of aggressive steps taken by the DPRK in the first half of 2009 (one nuclear test and several missile launches). As a result, China accepted tougher UN sanctions on the DPRK. The main questions remain, however, how far China’s influence really goes with such a uniquely problematic country and to what extent the Chinese leadership wants to exert whatever influence it has on the regime in Pyongyang. China has been loath to declare its real strength with regard to the DPRK, but in view of the fact that it supplies 50 per cent of the aid to the regime, and 90 per cent of its energy, it is clear that it does have some real traction there. The next logical question, then, is how far the Chinese leadership is willing to use this potential leverage. The answer during 2009 was only to a very limited extent. The suspicion remains that, whatever the DPRK does, China does not want to walk away from its ‘little brother’ with all of the unpredictable regional consequences this would entail.

Competition over energy security and non-proliferation (halting the spread both of conventional weapons and of nuclear technology to ‘rogue’ states) are
two very specific areas of potential conflict and misunderstanding in the US–
China relationship, and clear ownership of the dialogue on these two issues, with
the goal of articulating shared interests and near-term objectives, will be critical.
However, as long as the United States can understand China’s self-defensive
definition of its national interest and how this is expressed through its diplomacy
and action, it should not have grounds for systemic concerns in the medium
term, whatever the near-term frictions.

CHINA’S RISING INTERNATIONAL IMPORTANCE
China’s evolution from an inward-looking, isolated country has caused mixed
reactions in the United States. Where to collaborate with and where to oppose
this new China are questions that are working their way to the heart of the
policy debate in the United States, and that the Special Economic Dialogue was
partly set up to address in 2006. In many areas, particularly in Asia, China is
clearly in competition with the United States, trying to exercise greater influence
through the ASEAN-plus-three group, and through the Shanghai Cooperation
Organization, a grouping the United States regards with suspicion (witnessing
Russia and China trying to forge a united front again brings back bad memories).
Some commentators say that China is starting to present itself as an alternative
partner and even to offer an alternative model of state-led growth to replace the
now discredited ‘Washington Consensus’. At this stage, however, there is little
evidence that China will aggressively promote its economic model internation-
ally, and all the statements of its main leaders imply that this model is one that
is most suitable for China at its current stage of development, nothing more.11
Underscoring this point, in 2003 China’s leading ideologue, Zheng Bijian, started
to attempt to reassure outside observers, many of them in the United States, that
China’s rise was ‘peaceful’ (heping jueqi).12 Since 2007, and the 17th Communist
Party Congress in Beijing, the concept has evolved into one of ‘peaceful develop-
ment’, largely because many observers outside China found the use of the word
‘rise’ somewhat ominous.

At the same time, as a result of skilful soft diplomacy, China capitalized on
the fall in the reputation of the United States in the region after the invasion of
Iraq in 2003. In Cambodia, Thailand and the Philippines, surveys have shown
that the historical distrust of China has been replaced by an admiration for the
Chinese economic model and the political stability that the Chinese govern-
ment has achieved in the last two decades.13 Growing Chinese political influence
in the region and beyond has been backed up by a dramatic rise in the number
of Chinese students studying overseas, by increasing amounts of Chinese devel-
opment aid and by the establishment of Confucius Institutes in various parts of
Asia, Africa and Europe, to promote cultural and educational ties.
There is controversy, however, about whether China’s efforts to improve
the reach of its soft power have been particularly successful. Although artfully
embellished, China’s foreign policies and foreign assistance are, at heart, driven
primarily by its government’s perceptions of national economic need. At its best,
it has contributed to the development of poor resource-producing countries, notably in Africa, by increasing the value of their raw materials exports and through extensive Chinese-funded investments in modern infrastructure. At its worst, China’s self-interested munificence has aroused growing local criticism. In Africa, critics complain that its policy of ‘non-intervention’ has often amounted to giving financial support to tyrannical regimes, that too little of its investments benefits local economies, that local producers are overwhelmed by waves of cheap Chinese exports and that Chinese lending could plunge African borrowers into unaffordable debt. Some also worry that the result will be excessive economic and political dependence on China.¹⁴

There is plenty of evidence in blogs (which have become massively popular in China) and in China’s increasingly lively media that many in the Chinese government and media, as well as among the Chinese middle class, feel that their country is not being accorded the respect it deserves for its achievements over the last three decades. As the economic turmoil unleashed by the financial crisis spread around the world, governments in industrialized countries have been obliged to accept that the active involvement of China, and of other emerging economies, is no longer just desirable but indispensable to the restoration of global stability. That recognition was powerfully reflected in the decision by George W. Bush to invite their leaders to a first ‘Group of 20’ summit meeting in Washington in November 2008 to discuss the crisis and the subsequent G20 summit in London in April 2009, at which China was a central and active participant. In London, such was the importance of the two countries’ joint agreement to any final global economic deal that the talk was of it being in fact a G2 summit, though both sides rejected the moniker.

One thing that the talk of a G2 did capture, however, is that solutions to almost all global economic, environmental and political challenges will depend critically on the quality of the relationship between Washington and Beijing. President Bill Clinton often talked about trying to build a strategic partnership with China. President George W. Bush attempted to construct a framework in which both sides could work together on areas of mutual benefit and interest (most prominently in the US–China Strategic Economic Dialogue). But now that China has moved away from its original position of complete ‘non-interference’ in the affairs of other countries, ‘strategic partnership’ needs to mean much more than a deepening of US–China bilateral understanding and cooperation. China now has clear overseas interests and, like the United States a century before, will want to defend and promote them. The Obama administration’s enhanced ‘Strategic and Economic Dialogue’ goes some way to recognizing this new reality.

**CHINA’S INTERNAL TRANSITIONS**

But the management of this critical bilateral relationship is no longer something that the elite leadership of the Communist Party can decide upon alone. In the run-up to the next Communist Party Congress in 2012, the party will need to
manage a transition from the leadership of Hu Jintao to that of a new group, the so-called ‘Fifth Generation’ of Chinese leaders. As always, China’s civilian leaders will have to gain the support of the People’s Liberation Army for this transition. However, this transition will also need to gather and carry popular support somehow – a particularly difficult challenge given the lack of explicit mechanisms for engaging popular input into the process. The fact is that there are increasingly influential and vocal constituent elements in Chinese society that the leadership will need to continue to buy into the system – from a new middle class that might number over 100 million to a new group of entrepreneurs who are critical for the growth of the economy, were allowed into the party in 2001 and, according to the OECD, now account for over half of Chinese growth. In addition, there are 3,000 civil society groups agitating on the environment and over 12 million petitions were submitted in 2008 alone from disgruntled citizens. More Chinese are aware of, and willing to exercise, their rights. A successful transition to a new group of leaders in 2012 will depend on their having support across this complex blend of constituencies and being seen as legitimate in their eyes and representative of their views.

The Hong Kong-based commentator and journalist Willy Lam has expressed concern at the very slow progress of political reform and transparency in decision-making in China in the face of this rise in greater civic activism and politically aware constituencies. Even officials within the party admit that there is currently no clear road map to a more ‘democratic’ system of government, despite the government’s declaration in 2005 that ‘democracy is the common aspiration of mankind’. This slow pace of change is dangerous partly also because of the rise in Chinese nationalism, sometimes encouraged by the government, but increasingly citizen-motivated. Japan in particular, and sometimes the United States, appear to regard this nationalism as a source of external threat; this suggests that China needs to go it alone more often and stand up to what are seen as unreasonable external demands.

The idea, therefore, of an elite leader such as Mao Zedong or Deng Xiaoping doing backroom deals with US leaders is no longer tenable. Leaders of China cannot afford, now or in the future, to seem weak or compliant in their international dealings or detached from public concerns. Nor is it acceptable from a Chinese perspective for the United States to appear to be handing down edicts or acting, as it often did in the 1990s, like the world’s policeman. It no longer has the moral authority in China to get away with this kind of approach.

A different kind of approach may work, however. As noted by Mobo Gao, an Australia-based academic originally from China, survey after survey has shown that the Chinese still admire America and aspire to live lives similar to those in the United States, despite the damage done to its international reputation across Asia as a whole during the past decade. President Obama has sought to take advantage of this latent goodwill and has consistently identified during his first year the need for the United States to live up to the values that it publicly espouses if it is to re-establish the potential to exert US global leadership.
America and a Changed World

In this context, the United States may be able to play a constructive role in China’s need to address the hugely complex issue of its own process of gradual political reform. In view of the environmental, political and social challenges that China will face in the next decade, and the potentially cataclysmic fall-out if it fails to manage a smooth transition to a modernized system of political and legal governance, the United States, along with the EU and its member states, should seek to identify the areas where governmental and private or non-governmental initiatives could help indirectly in this process. These could include supporting the embedding of the rule of law, the growing influence of non-political civil society groups, the building of more professional media, and the construction of a financial services infrastructure. There will remain areas related to national security and sovereignty where engagement would be counter-productive and where China will need to face the challenges on its own. But for this long-term rapprochement to take place, both sides will have to overcome a great deal of historical suspicion as well as two more persistent areas of bilateral tension – the future of Taiwan and the imbalance in the bilateral economic relationship.

THE PROBLEM OF TAIWAN

The joker in the pack of US–China relations is Taiwan and the state of cross-Strait relations. This is an issue where the US position is critical. Taiwan’s development as a democracy since 1996 has been remarkable. The peaceful transfer of power from the more pro-independence Democratic People’s Party (DPP) to the KMT in the 2008 election was a process that was accorded international praise. The new president, Ma Ying-jeou, has promised to improve relations with the Mainland. He has talked of a greater China market, and indeed, in 2006, the first Mainland Chinese investment was made into Taiwan. In 2008–09, ‘three links’ (air, post and sea) between the two were established, and the People’s Republic of China has assented to Taiwan joining the World Health Authority as an observer, after many years of Taiwanese lobbying. But even an improved relationship with Ma’s government has not meant that China has granted Taiwan the diplomatic space for more than the most minimal forms of international participation. And Ma’s government remains vulnerable to criticism about what tangible political and security benefits it has gained from China in the last year.

Under the 1979 Taiwan Relations Act, the US executive is required to report to Congress if Taiwan comes under attack, and then consult with Congress on a response. In the last decades, since the formulation of the One China policy, the United States, along with much of the rest of the international community, has avoided all talk of sovereignty. Even so, there are valid questions about how long Taiwan can develop as a democracy without at least moving closer to independence. Many in the generation born long after 1949, when the KMT fled to the island, feel that they are Taiwanese first and Chinese second. Mainland China has never given up the threat of military action if Taiwan were to declare outright independence. It has over 1,000 missiles pointed at the island and has
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increased its expeditionary military capacity over the last decade. The capacity for the Taiwanese issue to be a major cause of tension is clear. As long as China remains a one-party state and Taiwan is a democracy, then, in the event of an attack by China, it would be politically unfeasible for the United States not to defend Taiwan, no matter what the political stripe of the US administration controlling the White House.

The issue of Taiwan, therefore, exacerbates all of the concerns in Washington about China’s military build-up. With an official increase in its annual military budget of 17 per cent, China’s overall military spending is around US$50 billion, although the true figure may be as high as four times this.\textsuperscript{19} Even though US military spending would eclipse this larger figure, the speed of China’s technical progress and the increased professionalism of its forces have raised the stakes. With Taiwan, China has a clear unresolved strategic objective. The United States has to continue to walk a line between supporting Taiwan – but not tolerating any declaration of independence (which would be deeply destabilizing for the region and the world) – and showing that it will not stand by if China were to adopt a military solution to this problem. The Mainland Chinese leadership’s legitimacy depends on not compromising on China’s territorial integrity. Support for the status quo is therefore likely until Ma Ying-Jeou leaves office (he can stay in power until 2016 if he wins the next presidential election in 2012). The risks for US–China relations could resurface if the next Taiwanese administration decides to follow in former President Chen Shui-bian’s footsteps and become more assertive of Taiwan’s independent status.

ECONOMIC TENSION BETWEEN CHINA AND THE UNITED STATES

No recent event has symbolized more graphically the global implications of China’s economic rise than the attendance by Hu Jintao at the hastily convened G20 summit in Washington in November 2008 and the follow-up summit in London in April 2009. After years of being singled out by Western critics as a source of international economic problems, China is now being greeted as an integral part of the solution and invited to take a place of honour at the top table.

Economically, of course, the United States still dwarfs China. Though the latter has grown rapidly to become the world’s second largest economy in terms of purchasing power parity, its gross domestic product, measured on the same basis, was still barely half that of the United States in 2008, while its income per capita was less than one-eighth.\textsuperscript{20} However, the gap is narrowing rapidly. If recent relative growth trends continued, China’s GDP, on a PPP basis, might draw level with that of the United States by as early as 2015 – though rather later on a nominal basis.\textsuperscript{21}

That prospect has led the economic relationship between the two countries often to be characterized as one of rivalry, especially by China’s American critics. But it is also increasingly one based on interdependence. The United States remains China’s largest national export market (although its relative importance
has recently diminished), a valued source of technology and know-how and, above all, a central pillar of the global economic stability that Beijing prizes highly.

China’s financial stake in the United States is also large. As the world’s biggest foreign owner of US dollars – amounting to an estimated 70 per cent of its total foreign exchange reserves worth US$2 trillion – and the largest holder of US government debt, it has a vested interest in America’s national welfare. By the same token, the United States has relied heavily on credit from China to help finance its persistent fiscal and current account deficits and to support its currency. That reliance is set to grow as Washington is obliged to borrow further to fund its recent bank bail-outs and economic stimulus packages.

These factors mean that the two countries are to a considerable extent bound together in a marriage of necessity, the break-up of which would almost certainly inflict grievous costs on both, and on the rest of the world. But like many other such alliances, it is bedevilled by repeated frictions and disputes and by undercurrents of mutual suspicion. Its survival depends less on a natural commonality of interests and more on their ability to cope with the inevitable differences and conflicts between them.

These tensions have ranged across a broad spectrum of economic issues, including China’s treatment of intellectual property, its alleged discrimination against foreign competitors and its overseas investment strategy in the United States and elsewhere. But the most sensitive and recurrent source of friction has arisen from repeated US complaints about the substantial imbalance in bilateral trade and angry allegations that this is due to China’s ‘manipulation’ of its currency. This issue reared its head during the confirmation hearings in Congress of Tim Geithner as Secretary to the Treasury in February 2009, when he was quoted as accusing the Chinese of currency manipulation.

The Special Economic Dialogue created by President Bush and headed by Treasury Secretary Hank Paulson from 2006 managed to keep dialogue open about these issues and to stop them boiling over into large-scale spats. Even so, some constituents in the United States are asking what the dialogue has achieved, especially since President Obama upgraded it at the start of his administration. There is a perception that in the economic area, just as in the geopolitical realm, China is too much of a self-interested actor. Hopes that a more dynamic domestic consumer market would appear on the back of the Chinese stimulus package and specific government measures directed at enabling increased consumer spending in the early part of 2009 now look premature. According to one US official, a consumer market on anything like the scale of that in the EU or United States is as much as a decade away. The concentration of so much manufacturing capacity in China in such a short period since 2001 has created its own problems; the economic downturn saw many factories in South China close with millions losing their jobs, raising the spectre of social instability.

However, the greatest problem is one of perception. Since 2009, General Motors, now 80 per cent owned by the US taxpayer, has been manufacturing most of its cars in China. In the same year, China became the world’s largest...
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manufacturer and consumer of cars. The symbolism of US consumers spending their money to buy cars from a US taxpayer-owned company that has its main factories and employment in China will be potent.

Since China’s economic reforms began, its policy-makers have viewed the United States as a role model and object lesson in how to structure a modern capitalist economy. China is obviously far from embracing that system in its entirety. But when undertaking change, it has often looked to America as a template, one it has then adapted selectively to its own particular needs and circumstances. That has been true both of reforms of its financial markets and of industrial policy, which has striven to create ‘national champion’ companies in the image of established US industry leaders. One Western analyst has characterized the approach as ‘backward-looking and imitative’.22

However, as the financial crisis has brought venerable US financial institutions crashing down and sent shockwaves through the world economy, Chinese respect for the American way of doing things has turned to scepticism. Indeed, some officials have expressed open contempt for American faith in the efficiency of unfettered financial markets.53 That Beijing has been gradually loosening direct state control over its banks, while Washington has been forced to step in to support troubled financial institutions, has added piquancy to their comments.

President Obama is therefore confronting a China that is less in awe of US economic might, but whose cooperation is even more necessary to the achievement of US national and global priorities. That shift could clearly increase Beijing’s influence and bargaining power in its dealings with Washington and with the rest of the world. Much will depend on whether and how China decides to use its strength. So far, the indications are that it will be exercised cautiously, although commentators noted that, during President Obama’s visit to Beijing in November 2009, the Chinese government showed very little flexibility, at least in public, on the trade deficit, the exchange rate of the Chinese yuan, and specific trade disputes.

The Chinese regime’s dependence on delivering economic growth as the foundation of its political legitimacy means it is likely to be heavily preoccupied for some time with combating the slowdown of its national economy. In addition, though Chinese officials have some technical expertise in international financial and monetary affairs, it is relatively limited, as is their familiarity with the high politics involved. In such circumstances, launching dramatic initiatives could risk embarrassing failure. For the moment, Beijing seems to have opted for a safety-first approach, even though some high-level officials (in particular the Chinese Central Bank Governor Zhou Xiaochuan) have floated the idea of the dollar being replaced as a global currency with an alternative. But for that to happen, the government would need to face the problems of making the Chinese renminbi convertible, something they have resisted till now.

Another source of potential friction would be a misjudged hostile Chinese bid for a ‘crown jewel’ US company perceived, or popularly portrayed, as vital to US national security. Since Congress defeated the attempted takeover of the major oil company Unocal by China’s National Overseas Oil Corporation in 2005,
China’s attitude towards large American acquisitions has grown more cautious. Nonetheless, depressed stock market valuations – and a desire to diversify its US dollar investments – could cause opportunism to prevail over prudence.

There are, fortunately, some restraints in place that could limit the scope of confrontation. One is that it would be difficult for the United States to legislate unilateral trade sanctions against China without violating World Trade Organization rules and inviting a successful legal challenge by Beijing. In that event, the United States could face the choice between a humiliating climb-down and flouting a WTO ruling against it. Since the WTO’s dispute procedures are the strongest lever that the United States possesses over China’s trade policy, such a move could weaken its moral and political authority.

A second constraint is that American and Chinese economic interests are now so closely intertwined that rash or aggressive actions on trade would quickly backfire, with potentially serious consequences for both economies. While the United States remains China’s largest national export market, plentiful supplies of cheap imports from China have contributed to US prosperity by enabling its economy – at least until recently – to grow at rapid rates without generating high inflation.

The fact that many of those imports are made in Chinese plants owned wholly or partly by US companies and sold under their brand names also changes the political equation. There is now a large, powerful and politically well-connected US business lobby with a vested interest in maintaining open trade with China and in fighting political attempts to restrict it. That is fundamentally different from the situation in the 1980s, when Japan was the target of bitter US complaints about its trade practices: because American companies had few investments in Japan, none had any incentive to oppose threats of trade sanctions. Indeed, in many cases, they led the charge.

Nonetheless, as long as serious imbalances remain on bilateral trade with China, they are likely to be a source of contention. Although undervaluation of the renminbi may have contributed to those imbalances, it is not their principal cause. The real culprit is the huge disparity between the two countries’ savings rates. For a variety of reasons, China saves vastly more than it consumes or invests at home, generating persistent trade and current account surpluses and swelling foreign exchange reserves. Conversely, America’s propensity for debt-financed consumption – by both government and households – has led to large external deficits, not just with China but with the world.

However, the current economic turmoil is changing the equation. As the credit crisis forces American borrowers to ‘deleverage’, and as American consumers cut spending in the face of recession, household savings are set to rise sharply. The result is likely to be a steady reduction in the US current account deficit and weaker demand for imports, from China and elsewhere. That might reduce one source of friction between Washington and Beijing – but at the risk of creating others.
CONCLUSIONS

The fundamental problem for the United States is that China remains a deeply complex actor. The interactions of its central and regional governments are highly particular: in some areas the central government can enforce policy implementation; in others the local government acts as a rule unto itself. In that sense, the United States is engaging not with one entity but with many different ones. A deal in Beijing does not necessarily carry any weight beyond the capital. The highly fragmented nature of the Chinese political and economic landscape is often forgotten because of the strong image that the central government likes to project. Beijing promotes a sense of unity, but this unity is highly vulnerable. Events in Tibet and Xinjiang, in 2008 and 2009 respectively, both prove that.

At the same time, the United States must try to encourage China to look beyond its immediate national interests and accept that its growing economic and political importance requires it to play a larger multilateral role. For most of the time since it joined the WTO in 2001, China has taken a back seat, although, along with India, its dispute with the United States over agricultural subsidies provoked the collapse of the 2008 Doha Round negotiations. This is ironic, because China has been perhaps one of the major beneficiaries of entry to the WTO.

However, if China is to become a ‘responsible stakeholder’, this would require the United States to share global leadership with it in those areas where each country has the greatest stake – from climate change negotiations and energy security to non-proliferation. It is far from clear that the full implications of such a development are grasped in Washington, including the degree to which it would be obliged to accommodate Chinese arguments and viewpoints that would often be radically different from its own.

In broad policy terms, there will be little change in US–China relations over the next five years in terms of grand strategy. The overall aims will remain the same: to identify common interests and work together, to acknowledge dependency – especially in the economic sphere – and to manage areas of potential conflict, such as Taiwan and trade policy. While the United States may dislike China’s political system and their ideological differences will persist, the two countries are becoming increasingly mutually dependent.

The real challenge for the United States, however, will be to react to and accommodate a China that is increasingly proactive beyond its borders, whose influence in some parts of the world will start to outweigh that of the United States, and that, politically, will be articulating positions led by a clearly diverse and complex set of domestic constituencies within China. The United States must find a way to respond in the pursuit of its own interests, without creating conflict. One clear policy goal for the Obama presidency should be to rebuild US influence and credibility in China and among the Chinese people, and to show that the goals that the United States represents – freedom, dignity for the individual and the rule of law – are still fundamental for the future stable prosperity of the world community and also for China itself. The United States
needs to continue building constructive bridges to the increasingly influential and diverse range of interested communities and constituents in China. It should be more willing to dare to talk of democratization and its connection to good decision-making and governance, something that is accepted by many in positions of influence in China despite the continuing demonstrations of ideological intolerance by the Chinese communist leadership.

It is imperative that the United States and China work together within an agreed framework on energy and environmental issues, as noted in other chapters in this book. The United States also needs to identify the very real constraints on China’s development at the moment – from demographics (an ageing and increasingly male population) to its economic model and energy inefficiency. The United States should not expect China to be able to step up to the plate and become a global leader when it is so clearly preoccupied by internal issues. But it has no choice but to encourage China to be a strategic partner, and help spell out a shared strategy. To achieve that, the United States needs to work with others to change the architecture of multilateral forums such as the World Bank and International Monetary Fund so that they are more representative not just of China but of other developing economies (see Chapter 14). In this way, at least some of the miscommunication that has marred US–China relations in the past can be avoided in the future.

NOTES
2 See Yasheng Huang, Capitalism with Chinese Characteristics: Entrepreneurship and the State (Cambridge University Press, 2008), for an excellent demonstration of this.
5 See Wang Jisi, ‘China’s Search for Stability with America’, Foreign Affairs 84(5), (September/October 2005): ‘The United States is currently the only country with the capacity and the ambition to exercise global primacy, and it will remain so for a long time to come. This means that the United States is the country that can exert the greatest strategic pressure on China’ (p. 39).
6 These are contained in Joshua Kurlantzick, Charm Offensive: How China’s Soft Power is Changing the World (New Haven, CT: Yale University Press/New Republic, 2007).
9 An eloquent exposition of China as a global collaborator and cooperative partner is contained in Bates Gill, Rising Star: China’s New Security Diplomacy and its Implica-


His most notable exposition of this theory, at least outside China, is in ‘China’s Peaceful Rise to Great Power Status’, Foreign Affairs 84(5) (September/October 2005): 9ff.

See Kurlantzick, Charm Offensive for these, especially chapter 9, ‘America’s Soft Power Goes Soft’, pp. 176ff.


See OECD, Economic Survey of China, available at www.oecd.org/document/21/0,2340,en_2649_34571_35331797_1_1_1_1,00.html (accessed 29 March 2006).


This is well covered in Susan Shirk, China: Fragile Superpower (Oxford University Press, 2007). Shirk speaks with particular authority: she was the Undersecretary of State covering China and East Asia under President Clinton.


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