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More Than Meets the Eye



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Editor's Note

Zhang Ping

A few notable events took place following Chinese President Xi Jinping's first state visit to the United States in September, with the U.S. sending a warship to the disputed waters in the South China Sea garnering the most attention. On the surface, the move could be seen as a distraction, especially considering President Xi's success in improving the somewhat pessimistic tone that preceded the visit. Yet, in reality, it is another reminder that the two nations have divergent strategic goals and that the relationship needs a lot of caretaking, most importantly deliberate efforts to remain focused on building better understanding and, ultimately, trust.

It is natural that relations between China and the U.S. will encounter problems, even cold spells. The recent episode in the South China Sea challenges both Beijing and Washington to remember what brings the two countries together. Cooperation is always better than confrontation.

"More than Meets the Eye" is the headline we selected for this issue because, as our contributors agreed, President Xi's visit was not only "just in time" but also "more fruitful than expected." Cheng Li of the Brookings Institution argues in the lead article that Xi succeeded in changing the somewhat pessimistic tone that preceded the visit, stabilizing the relationship and managing to go home with quite a few positive outcomes.

Now as "the downward spiral" in bilateral ties is for the present halted, and new areas where the two countries can collaborate identified, the odds are growing that China and the U.S. can escape the "Thucydides Trap" of power conflict.

Also for this issue, we offered expert analysis in a number of areas where the two sides have achieved significant—if not historic—agreements, including climate change, cyber security and collaboration in outer space.

Another "more than meets the eye" situation is the announcement that the U.S.-led Trans-Pacific Partnership (TPP) negotiations were concluded, absent of China's participation. Our contributor, Mr. He Yafei, argues that the move was an attempt by the U.S. to hold on to its control over global rule-making.

Global investors have become increasingly jittery about China's economy, which didn't escape our attention. Two Chinese experts, Mr. Yu Yongding and Mr. He Weiwen, try to calm nerves by analyzing why China's economy will not crash, and noting that the RMB's rise and fall serves global interests well.

We continue to hope this publication will help you to gain insights into key issues facing the two nations, and better understand why China-U.S. ties, arguably the single most important bilateral relationship in the 21st century, matters to you and the world.

Happy reading!



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More Than Meets the Eye

Chinese President Xi Jinping recently concluded his state visit to the United States. Although the Obama-Xi meeting left much to be desired on contentious issues such as cyber security and the South China Sea, it was a significant and pleasant surprise that Xi softened some of the more pessimistic and suspicious sentiments in such a short time. Using words that appealed to the American public, Xi highlighted his respect for the U.S. and its people. At the same time, the U.S.-China consensus that was reached on cyber security was also an important development. In total,

the Obama-Xi meeting accomplished more than anticipated.

Xi's visit featured different phases in Seattle, Washington D.C., and New York—all of which received some positive feedback. Xi's performance at the welcome dinner in Seattle provides a good example. Beforehand, amid widespread concerns about China's economic slowdown and cyber theft (cyber-security issues), many American corporate representatives expressed their doubts about the Chinese economy and whether or not Xi could present a



Cheng Li
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(Photo by Pete Marovich / Bloomberg)

Although the Obama-Xi meeting left plenty to be desired on disputed issues such as cybersecurity and the South China Sea, it was a significant and pleasant surprise that Xi softened some of the most pessimistic sentiments and disarmed suspicions in such a short time, highlighting respect for the U.S. and its people, in appealing words to the American public.

strong case. But Xi's speech succeeded in addressing many of their concerns and influenced many to re-evaluate their cynical and pessimistic views.

Xi's purchase of 300 Boeing planes also illustrated the strength and potential of the Chinese economy. In addition, Xi's meeting with IT industry insiders touched upon key issues such as Chinese market access, intellectual property rights, and cybersecurity. This laid the groundwork for his state visit to Washington D.C. and alleviated the tense atmosphere preceding his visit.

In fact, the core purpose of the Chinese leader's visit was to deescalate tensions, enhance mutual respect, and emphasize the importance of peaceful co-existence.

First, the goal of Xi's visit was to reiterate that the U.S.-China relationship is not zero-sum and need not take a collision course. In the past few months, the amount of friction in U.S.-China relations escalated the likelihood of unintended conflicts. Xi's visit was successful in reducing the possibility of conflict and further deterioration of the relationship.

Second, Xi's visit furthered the extensive cooperation between both countries. Though the two sides failed to reach a consensus on the South China Sea issue, Xi did address the topic of de-militarization. Regarding cybersecurity, the two parties also established a framework agreement. The framework adopted a new term, "cybercrime," instead of "cyber theft," which the Chinese found offensive. This demonstrates the constructive interaction between the two countries. As a result, advancement in the protection of commercial intellectual property rights is expected. This was clearly demonstrated

The true focus of Xi's U.S. visit was not actually on China's international dimensions. Instead, the visit was intended to promote economic and other reforms back home.

by the corresponding meetings Xi had in Seattle. In addition, the fact that the guests of honor at the main table of the White House state banquet were predominantly CEOs from the financial sector and technology companies show the promise in China's financial liberalization and gradual opening up of its IT industry.

Third, the visit will promote the continued implementation of China's domestic reforms. The true focus of Xi's U.S. visit was not actually on China's international dimensions. Instead, the visit was intended to promote economic and other reforms back home, and this was achieved

through demonstrations of respect, prestige, and promises that Xi won on the international stage.

Although Obama avoided adopting the "new type" terminology, his administration's recognition of "non-confrontation" and emphasis on mutually beneficial cooperation and mutual respect is comparable to what China defines as a "new type of major-country relationship." The American side has applied concepts that represent "new-type" ties—only they have not adopted a formal expression like that of the Chinese.

At the Sept 25 State Department luncheon Vice President Biden hosted in Xi's honor, Xi departed from the prepared script during his speech, saying he was "deeply moved." This was an indication that the two heads of state had positive interactions during their private talks the previous night. Otherwise, Xi would not have displayed his more personable side. To confirm the success of the state visit, at their joint press conference, Obama described the meetings as "extremely productive." Both leaders' optimistic expressions were indicative of the fact that Xi's U.S. visit was extremely fruitful.

The Obama-Xi meeting took place in a challenging atmosphere, but at the same time, that meant the leaders were eager for a favorable outcome. The Xi visit was not only very smooth, but also resulted in the two countries building a strong strategic framework, and they are now embarking on a path of cooperation instead of one of confrontation.

Finding Common Ground

The 2015 Obama-Xi Summit must be judged a success. Although areas of disagreement are real and run deep, and not easily resolved, progress was made, trust was built, and the two great powers on the planet have stabilized their relations. The question is: How long will it last?



David Shambaugh

*Professor
George Washington
University*

China's President Xi Jinping and his team should be very pleased – and very relieved – with the outcome of the recent summit meeting with President Obama. They got in and out of Washington without any public embarrassments or disagreements. Even the few public references to disagreements that President Obama, Vice President Biden, and Secretary of State Kerry made were contextualized as the normal part of a complex relationship that had to be managed. As President Obama noted at their joint press conference: “I’m committed to expanding our cooperation, even as we address disagreements

candidly and constructively. That’s what President Xi and I have done on this visit – during our working dinner last night and our meetings today.” This is a reflection of President Obama’s personal diplomatic style, as he is not confrontational in public and polite in private. President Xi was also dignified and calm in all of his public appearances. Both men sought to accent the positive in the relationship.

Thus, from the Chinese perspective, a primary goal was accomplished: lots of photos of summit pageantry (honor guard welcoming ceremony and

elaborate state dinner) and minimal public embarrassment. President Xi and his delegation were exposed to many demonstrators—including just outside the White House and State Department and their protests were audible throughout the Rose Garden joint press conference. Overall, though, the media “optics” and symbolism of the visit should have satisfied Beijing.

entreaties for becoming a “responsible international stakeholder” as another plot to retard China’s rise by getting it overextended in the world.

But, in the interim, China has gained more multilateral confidence and has stepped up its contributions to various global governance activities—in peacekeeping, public health, counter-terrorism, climate change, nuclear security, anti-

Substantively, the major message conveyed by the summit was of the world’s two major powers doing their best to work together on a broad menu of global-governance issues.

Substantively, the major message conveyed by the summit was of the world’s two major powers doing their best to work together on a broad menu of global-governance issues. A detailed “factsheet” of US-China perspectives on “global and regional challenges” enumerated specific areas of cooperation. This was also apparent in both presidents’ public comments, as well as those by Vice President Biden and Secretary Kerry.

Clearly, the Obama administration still places a high premium on China as a partner in global governance. This was their priority when they came into office seven years ago and was the centerpiece of Obama’s own November 2009 state visit to China—only to be rebuffed by the Chinese side. At that time, China still lacked confidence in the multilateral arena and suspiciously viewed American

piracy, sustainable development, humanitarian assistance and disaster relief, and other areas—and it is thus now more possible for the two powers to cooperate. Xi Jinping himself signaled a greater receptivity to China’s diplomatic activism. As President Obama told him at their joint press conference: “President Xi, I want to thank you again for expanding your commitment to cooperation between our nations. I believe that it’s another reminder that as we work to narrow our differences, we can continue to advance our mutual interests for the benefit not only of our two peoples, but for the benefit of the world.”

Even if it is not a G-2, global governance cooperation could prove to be the missing “glue” to the strategic relationship in recent years. This summer’s Strategic and

Clearly, the Obama administration still places a high premium on China as a partner in global governance.

Economic Dialogue similarly placed a premium on global cooperation. So, almost by stealth and amid much clamor over the two government's many differences, perhaps some ballast is being rebuilt in the frayed relationship.

While important for the world as well as both powers, global-governance cooperation is not a panacea for restoring full health to the troubled Sino-American relationship. The reasons for the troubles are well-known, they are real and run deep, and not easily resolved. Management of them—containing them from hemorrhaging into other areas of the relationship—is a diplomatic accomplishment. Occasionally—as appears to potentially be the case with the cyber corporate espionage issue at this summit—actual tangible progress can be made. Another example: military confidence-building measures to avoid accidents at sea or in the air that could escalate into an armed confrontation.

Progress in sensitive and difficult areas such as these can be achieved only through intensive diplomatic engagement—and presidential summits offer the needed opportunity to forge consensus that is difficult to reach by second-level officials (this is known as “action-forcing diplomacy”). That, in itself, is sufficient reason to hold periodic presidential summits. The other reason, though, is for direct and straightforward discussions at the highest levels of government on areas of serious disagreement—lest they fester and metastasize. The third reason is to

forge tangible cooperation in specific areas wherever possible.

In these three regards, the 2015 Obama-Xi Summit must be judged a success. Progress was made, trust was built, and the two great powers on the planet have stabilized their relations. The question is: How long will it last? Previous summits over the past decade have exhibited such a stabilizing pattern—only for mistrust, disagreements, and acrimony to return after passage of a few months' time. If nothing else, that is a strong rationale to hold bilateral summits (which need not be state visits) at regular six-month intervals. Both nations and the world need the stability summits provide. The history of Sino-American relations since President Nixon and Chairman Mao met back in 1972 shows clearly that presidential involvement and investment is imperative to keeping the relationship on track.

The history of Sino-American relations since President Nixon and Chairman Mao met back in 1972 shows clearly that presidential involvement and investment is imperative to keeping the relationship on track.

Competition for Strategic Partners

By re-engaging with its neighbors, especially American allies, in a formal alliance system, China would set up the function of preventative cooperation. That would help to maintain regional peace and security.



(Xinhua Photo)



Yan Xuetong
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No one would have imagined in late 2012, at the start of Xi Jinping's tenure as president of China, that by September 2015 leaders from three US allies would attend an extravagant military parade put on by Beijing to celebrate the end of the Sino-Japanese War 70 years ago. But there they were – President Park Geun-hye of South Korea, President Miloš Zeman of the Czech Republic and Deputy Prime Minister

Prawit Wongsuwan of Thailand – standing near President Xi earlier this month surveying the impressive display of modern military might.

America is still the world's only superpower, but China is gradually catching up. China's economy has become the second largest in the world, and the leadership is speaking with a louder voice in international affairs. And while historically

China has eschewed building formal alliances with other countries, even that policy is slowly shifting: Beijing is courting new partners, including allies of Washington like President Park and others.

But for China to become a superpower like the United States, Beijing needs a new strategy that fully embraces genuine alliances, and not just so-called “strategic partnerships.” True allies are most often bound by treaties that commit each country to defending the other in times of security conflict or war, while “strategic partnership” is only a nice diplomatic jargon for a bilateral relationship involving any number of agreements – often economic in nature – that falls short of true alliances.

The concept of alliances has been anathema to Beijing since 1982, when China adopted a non-alliance policy to avoid getting entangled in the Cold War. This position reduced the risk of being dragged into conflicts among other states, especially between the U.S. and the Soviet Union, while allowing for more independence in policy-making. Later on, freedom from diplomatic obligations was a policy that allowed China to focus energies on building its economy.

China’s current list of friends is no match for America’s. At present China has established about 70 “strategy partnerships” or “cooperation partnerships,” including with many American allies, such as Britain, France, Germany and Italy. These friendships are mostly economic in nature, not traditional, full-fledged military alliances, whereas the U.S. has about 60 full-fledged treaty allies that involve military cooperation. By that standard, China has only one full-fledged ally, namely Pakistan, which signed a joint statement with China to upgrade their relationship to an “all-weather strategic partnership of cooperation” early this year.

The ordinary strategic partnership cannot consolidate the bilateral strategic cooperation as reliably as a military alliance. The fundamental difference between domestic society and international society is that there is no central government monopolizing military power in the latter. Thus all states without enough military capability to protect their own security have to rely on a foreign military power or organization for the sake of survival. In comparison with economic aid, military protection is more crucial for the secondary or small states. Surrounding countries will support China to achieve national rejuvenation if in return it provides security protection to those states by making alliances. In the absence of that kind of promise, these neighbors fear that China could use military might against them.

In terms of strategic competition

China’s current list of friends is no match for America’s.

with the U.S., China also needs more military allies in order to maintain a political balance in East Asia. Due to the world's center shifting from cross-Atlantic to the Asia-Pacific, it is very possible for the U.S. to strengthen its Asia-Pacific rebalance strategy if it wishes to constrain China's rise. China will be able to shape a favorable environment for its national rejuvenation if it resumes its alliance tradition from before 1982, especially making new alliances with American allies in Asia Pacific. The more US allies in this region become China's allies, the slighter chance for Washington's rebalancing strategy to achieve its goal.

Although the presence of many foreign heads of state at the military parade shows China's foreign strategy is slowly shifting towards developing more military cooperation with as many countries as possible, the strategy is also faced with another obstacle related to the non-alliance principle, namely economic determinism. In the last three decades, economic achievement has dominated the minds of Chinese people, and thus "improving political ties with economic approaches," called *yi-jing-cu-zheng* (以经促政), has become the dominant form of China's diplomacy. Economic partnership is

better than no strategic cooperation, but it does not have the same impact as military alliance on bilateral strategic relations.

China should start by forming alliances from its own neighborhood. Geopolitically speaking, China must attain the strategic support of surrounding countries in order to achieve the goal of "national rejuvenation." It is hard to imagine that China can become a world-leading power without a majority of its neighbors accepting its role as the regional leader. The task of national rejuvenation is not only much more difficult than economic development but also requires a different foreign strategy, which gives the top priority to military cooperation with surrounding countries. It is almost impossible for a power to play a leading role in the world when it does not have a safe neighborhood.

It is unrealistic to argue that China is able to make alliance with most of its neighbors in the short term. Nevertheless, there is potential for Cambodia Laos and the six members of the Shanghai Cooperation Organization to upgrade their relations with China to full-fledged military allies, like Pakistan, with the title of all-weather strategic

In terms of strategic competition with the U.S., China also needs more military allies in order to maintain a political balance in East Asia.



The more US allies in this region become China's allies, the sligher chance for Washington's rebalancing strategy to achieve its goal.

partnership of cooperation. The U.S. is certainly the major strategic competitor of China, but its conflict with some of China's neighbors produces the possibility for those states to return to China for protection. Those states, particularly most of the ASEAN states, prefer no regional military dominance from either the U.S. or China. Making alliance with both China and the U.S. is a strategic approach similar to non-alliance strategy helping them to reduce dependence on or threat from either China or America.

In fact, a deeper bench of allies for China would provide a counter-balance to America's reach, and make the world a more peaceful place. Most people in the West may prefer a unipolar world led by the United States, but not all the world sees it that way. A global balance of power tipped in favor of any one country creates more problems than it solves. All ASEAN states know that the only way to maintain ASEAN's leading role in regional security affairs is to maintain the balance between

China and the U.S. and force them to compete for ASEAN's support.

China made the right decision to establish economic strategic partnership with those countries, including America's European allies, who have neither border disputes nor security conflicts with it, while military alliance is not practical at present. Among all of its neighbors, Japan, the Philippines, Vietnam and North Korea have least possibility to make alliance with China. Although the Treaty of Friendship, Cooperation and Mutual Assistance between China and North Korea has not been abrogated, it has become merely nominal. There have been neither military relations nor state summits between these two countries for years. China has to be patient to wait for the domestic change in these four countries, which will change their policy towards China. The Philippines could be the first one because its current president, Benigno Aquino III will step down next year in accordance with the Philippines constitution.

It is hard to imagine that China can become a world-leading power without a majority of its neighbors accepting its role as the regional leader.

China should learn from the competition between the U.S. and the Soviet Union in the Cold War. The failure of the Soviet Union is partially due to its lack of strategic credibility to its allies, namely those who did not trust Soviet security protection. On the contrary, most of its allies were fearful of Soviet military might after its military interventions into Hungary in 1956 and Czechoslovakia in 1968. That is why the Warsaw Pact was ended before the collapse of the Soviet Union, after East Germany took the lead to sign out this military organization in 1990. In contrast, America's alliance credibility made a great contribution to its winning of the Cold War. This history can explain why Obama's rebalancing strategy gives the top priority to relations with traditional allies.

Many people both in China and America have argued that the world would fall into a new Cold War if China adopted an alliance strategy. But an alliance network is only one of the necessary conditions for a Cold War, rather than a sufficient one. In fact, there is little chance of a new Cold War given that ideology is not a core conflict between China and the United States. Millions of Chinese and Americans visit each

other's country annually, not to mention the extensive economic ties between these two countries, factors which also reduce the chance for a new Cold War in the visible future.

It will be crucial to the whole world to prevent military clashes between China and the U.S. and maintain their competition peacefully when China becomes a full-fledged superpower in the next decade. Because conflicts and competition between these two giants are increasing, preventative security cooperation becomes more important than economic cooperation. Establishing norms to govern cyber security is a typical case. If China makes alliance with neighbors, especially American allies, it has some function of preventative cooperation. It can help to maintain regional peace in three aspects. First, it will reduce the security conflicts between China and its neighbors after they become allies. Second, it will decrease the danger of American involvement into conflicts between its allies and China. Third, it will transfer the asymmetric military balance to relative symmetric balance in Asia Pacific, making both sides more cautious about any military action.

No Thucydides Trap

The relationship between a rising power and an established power has always been a complicated one. Since the 16th century, there have been four major cases of rising powers interacting with established world powers – all resulting in conflict. However, during the recent state visit by Xi Jinping to the United States, both countries' eagerness to seek cooperation was on full display.



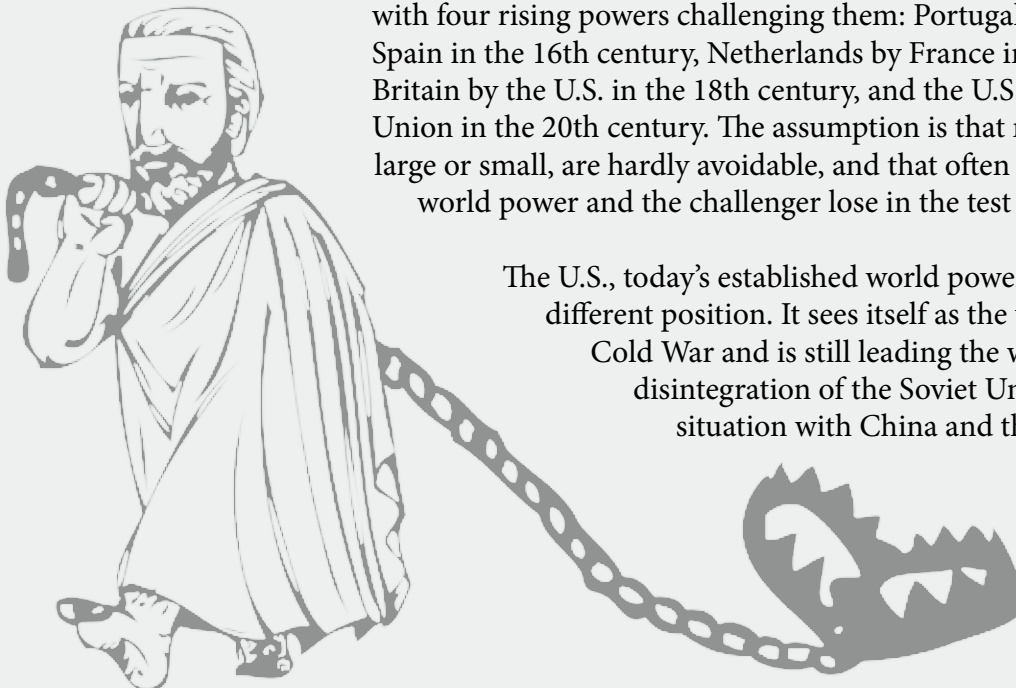
Wu Zurong

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On his first state visit to the United States, Chinese President Xi Jinping's effort to reassure the world that the Sino-U.S. relationship is on the right track was considered one of his most important achievements. The two countries believe they can avoid being caught in the so-called Thucydides trap — so long as they take care not to lay the trap for themselves — by working together to build a new model of major-power relations. By breaking away from the old-world pattern, in which the rise of a major power leads to military conflict with an established power, China and the United States can shape the future of the world.

Since the 16th century, there have been four established world powers with four rising powers challenging them: Portugal was challenged by Spain in the 16th century, Netherlands by France in the 17th century, Britain by the U.S. in the 18th century, and the U.S. by the Soviet Union in the 20th century. The assumption is that military conflicts, large or small, are hardly avoidable, and that often both the established world power and the challenger lose in the test of strength.

The U.S., today's established world power, is in a somewhat different position. It sees itself as the winner in the Cold War and is still leading the world following the disintegration of the Soviet Union. However, the situation with China and the U.S. is different





Chinese President Xi Jinping delivers a speech during a welcome banquet jointly hosted by Washington State government and friendly communities in Seattle, the United States, Sep.22, 2015. (Photo by Liu Weibing)

from the four previous cases, and the so-called general “rule” of such relationships has become outdated.

Thanks to globalization, the economies of China and the U.S. have become extremely inter-related. If the economy of China stagnates or slides into a recession, the U.S. economy cannot avoid being affected, and vice versa. That situation between the established world power and the rising power has never existed before. Also, both China and the U.S. have become the

major contributors to the strategic balance and stability in global security. Therefore, any kind of large-scale conflict between China and the U.S., whether militarily or economic, is highly undesirable for both sides, and would not yield a winner. This reality constantly stimulates both countries to work together for win-win cooperation.

Another reason the relationship between China and the United States is a new brand of great-power relationship: the consequences that

“There is no such thing as the so-called Thucydides trap in the world. But should major countries time and again make the mistakes of strategic miscalculation, they might create such traps for themselves.”

— Xi Jinping, Seattle (Sept 22)

could result from a large-scale conflict or war between the two countries. With advancements in science and technology, as well as in military strategy and equipment in recent decades, the destruction inflicted in a modern large-scale war would be many times greater than in those of past centuries. The use of weapons of mass destruction in war will be even more horrible and damaging. Undoubtedly, peaceful co-existence is the best choice for China and the U.S.

Finally, the progressive understanding of international relations by President Xi Jinping is one that had not been possessed by the leaders of rising powers in the past. China is devoted to building, by mature theory and practice, a modern relationship between China and the United States that seeks a win-win scenario. No matter how strong it becomes in the future, China will never seek hegemony and spheres of influence, or engage in expansion. China does not wish to overthrow the current world system and to build another of its own, but instead seeks to work together with all the United Nations members to improve it. A more rational and just world system will be more helpful to achieving common development and lasting peace.

During President Xi Jinping's visit to the U.S., China and the United States reaffirmed their desires for mutual understanding and strategic trust, and to remove arbitrary doubts about each other. With continuous efforts by both countries, China and the U.S. could manage to avoid miscalculation and misjudgment about each other's strategic intentions, as well as refrain from setting the so-called Thucydides trap for themselves.

Any kind of large-scale conflict between China and the U.S., whether militarily or economic, is highly undesirable for both sides, and would not yield a winner.

Beyond the U.S.-China Narrative

It is hard to avoid the U.S.-China bipolar narrative, although this over-simplistic analysis misses other measures of global power and insecurity. Xenia Wicket argues there is no single paramount power, but a variety of nodes of state and non-state actors.



It is hard to get away from the U.S.-China bipolar narrative. Despite the presence of dozens of world leaders in New York for the September UN General Assembly meetings — including, for example, Indian Prime Minister Modi — the media was focused on Chinese President Xi and the U.S.-China relationship (although the Pope was

some distraction). With the announcement of successful Trans-Pacific Partnership (TPP) negotiations a week later, much of the rhetoric is whether the U.S. has done this to counter China's rise. It is difficult for analysts to look beyond this bilateral relationship.



Xenia Wickett
U.S. Project Director
Chatham House

As a former senior U.S. government official told me last year, it is hard to stop looking at the ‘bright shiny object’, in this case China. It is bigger and moving faster than anything else. And thus for most it becomes, like Japan before it, either a potential threat to U.S. leadership, or an opportunity.

Such thinking is not restricted to the United States. In a series of interviews with senior officials and other analysts in China, India, Japan and other Asian nations, we found the common narrative of the power balance in Asia revolves around the idea of U.S.-China bipolarity.

Nevertheless, as shown in our recent report, ‘The Asia-Pacific Power Balance: Beyond the US-China Narrative’, this bipolar perspective does not fit the reality. As one looks out 15 or so years, it will become even less reflective.

Power was historically measured by the size of one’s military or economy. But today, such simplistic analyses are vastly outdated. A

much more diverse set of tools needs to be considered in analyzing the relative power and influence of different actors. But even in these two areas, the message is a far from straight forward one.

While America has the largest defense budget, China has the largest active military in the world. Yet neither are measures of capability. If one takes into consideration such issues as equipment, training, operational history, and interoperability with allies, it is clear that the U.S. can bring to bear, with its partners, the most force in this arena. At the same time, questions have been raised regarding America’s will to use its military. Further, the military is a tool to address only certain problems, and increasingly it is the non-traditional challenges that are becoming more tangible.

Economically, China’s GDP surpassed that of the United States (by purchasing power parity) last year, and Japan’s in 2010 (using market exchange rates). By another important measure of economic



(iStock Photo)

There exists a ‘flexi-nodal’ Asian-Pacific region in which there are many actors who come together in different groupings dependent on a specific issue and their respective interests, will and capabilities.

With new actors, tools, technologies and networks the region is becoming more complex, with decision-making becoming harder.

power, GDP/capita, the U.S. will have the most pull for many decades. But most of the Asian-Pacific powers have China as one of their top trading partners, if not the top one. And so, dependent as they are on China, it has great influence (although the TPP in time may diversify this picture somewhat).

Demographics must also be taken into consideration, and here Japan and China have major challenges ahead with aging populations and total numbers in long-term decline. The U.S. also has an aging population but immigration in particular is helping manage this process. India, on the other hand, still has more than a decade of demographic dividend to enjoy.

Two other areas, natural resource access and cyber capabilities, have a significant role to play not least in terms of a nation's potential vulnerabilities or resilience. On the former, the U.S. is again strong while in energy, water and food terms the other major Asian powers have notable weaknesses that are

growing with rising demand. Both the U.S. and China in particular have strong cyber resources although those of India and Japan are rising too.

There are many other measures of power. The proliferation of trilateral and plurilateral groups in the region (from the U.S.-India-Japan trilateral right up to the East Asia Summit) affects the ability of a nation to call upon partners for assistance. Other tools from diplomacy and development assistance to culture to the media play a role. At the same time, attention must also be paid to non-state actors, from a nation's business sector (which wields enormous financial power) to its NGOs and civil society (which at least in the U.S. case provide more resources to international development than does the U.S. government).

When all these instruments of power and more are taken together, the picture that emerges is not a clear-cut one in which the U.S. and China are balancing off against one

another. Rather, it is one that increasingly can be represented by four characteristics or trends.

Changes (such as economic and demographic trends) in the region are occurring more rapidly and with greater volatility. New actors from international businesses and NGOs to institutions such as the EAS or ASEAN plus 1 and 3 are rising fast and, in many cases, disrupting the established system. These actors, along with other factors such as new technologies, are resulting in power becoming more diverse and diffuse.

With new actors, tools, technologies and networks the region is becoming more complex, with decision-making becoming harder. This complexity is only enhanced by the rising interdependence among nations within the region.

What these four characteristics point to is a different reality from the bipolar one – instead there exists a ‘flexi-nodal’ Asian-Pacific region in which there are many actors who come together in different groupings dependent on a specific issue and their respective interests, will and capabilities. There is, in this vision, no single paramount power, nor in fact, a clear trend of

rise or fall of one or other nations. Instead it is a world defined by many nodes.

Success in this reality will come to those who have many tools at their disposal and who are able to partner with a wide variety of actors, both other states and non-state actors. Nations that can be flexible and adaptable, that are able to move to respond to events, will realize the greatest good for their populations.

This more complex vision of the region is perhaps less appealing – it is certainly less clear and predictable. But it is more reflective of reality and is likely to lead to better analysis and policy-making. It also has one other significant benefit: While the bipolar vision can lead to Cold War-esque zero-sum analysis that could descend into a self-fulfilling prophecy, the flexi-nodal narrative, in its complexity, avoids this danger.

Time to Join Forces for Climate War

Seventy years ago, China and the U.S. fought side by side in World War II, and now have to work much more closely to provide public good for the world. Increasing cooperation on combating climate change was one of the most anticipated outcome of Xi Jinping's state visit. Collaboration on clean technology, energy-sector reform, and energy security could contribute to the stability of the world's economy and efforts in tackling climate change.

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In less than twenty days after celebrating, in different ways, the 70th anniversary of victories in WWII, President Xi met President Obama in Washington for his first state visit to the U.S. as Chinese president. Unlike 70 years ago, the common enemies the two countries face this time is no longer Japanese militarism, but instead, economic uncertainty and climate change.

This was the third formal meeting between Xi and Obama, and is likely to be the last. The first one was in June 2013, the “private” meeting held at the Sunnylands in California. The two reached agreement to build the “Sino-U.S. new type of major-power relationship,” and together with the development of their personal relationships, provided impetus to build mutual trust and set a clear strategic direction for the Sino-U.S. relations. The second was in November 2014 during

the Beijing APEC summit, when President Obama made state visit to China. The outcome was very successful, including the “Sino-US Joint Declaration on Climate Change,” a landmark moment after years of international climate change negotiations, bringing a bright prospect to the UN Climate Change Conference in Paris at the end of 2015. For the third meeting between President Xi and Obama, both countries and the international community had good reason to have high expectations.

However, this meeting took place at a time with more difficulties and complications. Since 2015, Sino-U.S. differences on a range of issues have deteriorated. Although some progress was made in June during the seventh round of Strategic Economic Dialogue (S&ED), inevitably hot-button issues negatively affected the bilateral relations.



Collaboration on clean technology, energy-sector reform, and energy security could provide new impetus to China's economic transition, but also provide more support for the U.S. economic recovery, and at the same time contribute to the stability of the world's economy and efforts in tackling climate change.

A series of recent fluctuations in the Chinese and the world economies, however, reminded everyone of the necessity for the two countries to cooperate. The Shanghai A-share index has fallen about 40% from its high point in June. Prices of mass commodities, including crude oil, experienced another sharp fall after an unexpected devaluation of the Chinese renminbi in August, followed by disruption in European and U.S. stock markets. Weak demand from China also dampened the expectations of oil prices, adding a threat to the U.S. shale boom, upon which it has based its economic recovery. The road to transitioning the Chinese economy to a “new normal” is anything but flat, and the expectation of the Fed raising rates has complicated overall implications on the world economy, especially for the emerging

economies. Economic decision-making in the world's two largest economies in the coming months may have decisive impact on the world economy as it approaches 2020. Reaching a coordinated and common understanding of respective economic policies at the third meeting between presidents Xi and Obama will have immense importance for stabilizing the world economy.

Climate change negotiation has also reached the most critical time. After Xi's visit to the U.S., less than 10 weeks remain before the UN climate conference in Paris. Whether Xi and Obama could bring further consensus and cooperation between the two largest emitters is also a development eagerly anticipated by international community.

Ironically, the world now faces a similar economic difficulty as before Copenhagen in 2009, only the U.S. and China have switched positions. Back in 2009, the Chinese economy outperformed the rest of the world under the \$4 trillion stimulus package, while the U.S. and Europe were struggling in financial turmoil. The 2008 economic crisis was regarded one of the reasons for the failure of Copenhagen 2009. Now the Chinese economy is a real concern to many, with worrying indicators in industry and energy demand, whereas the U.S. economy is on track for strong recovery partly driven by the shale oil and gas boom, with an employment rate higher than expected. Could there be a different outcome from 2009 due to this role reversal?

The Chinese government needs to make hard choices in 2016. Is it to go back to the old path of heavy industrialization and investment to stimulate the economy, or insist on restructuring, implementing the long-awaited reform in production factor pricing and state-owned monopoly enterprises? The former means greater environmental risk, possibly making the early conservation efforts in vain, while the latter means enduring greater pain in economy in the short term. Given the scale of the Chinese economy and environmental impacts, either choice would have global implications.

However, environment protection and economic development are not necessarily an either-or choice. Good investment can also drive good economic transitions.

If the Chinese government could make better use of market mechanisms to control pollution, providing a supportive environment for clean energy and environment technologies, China's environmental-protection efforts and carbon-reduction targets could turn into huge economic opportunities. The total environmental investment needed during the "Thirteenth Five Plan" in China is estimated to be more than \$1

trillion, while the Chinese government can only provide 15% of the funds. The United States can use its own experience and technology to help China to achieve this goal, while bringing greater market opportunities for American companies.

Investment and technical cooperation in key areas have been identified and agreed by both governments in the latest S&ED, including heavy-load truck fuel standards, electric vehicles, shale gas, industrial boiler efficiency, and smart grids. The Chinese government hopes to promote public-private partnership (PPP) projects in these areas as primary means of stabilizing economic growth, but inadequacy in protecting private investment and poor coordination in project management between private and public partners are still prevailing barriers. The Chinese government could learn from U.S. experience in effectively utilizing market forces to guide and encourage private investment towards these areas.

China also needs to deepen the reform in the energy sector. Since the Third Plenum of the Eighteenth Party Congress, President Xi has repeatedly pledged to carry out reform in monopolizing state-owned enterprise, and to let the market be the decisive power in allocation of resources. Progress was made in the past two years, but only slowly. If China wishes to replicate the shale boom of the U.S., it needs to break down the restrictions of access to oil and gas resources, to establish a vibrant oil-and-gas trading system, and continue to push for reforms in oil, gas and power markets. As a cleaner fossil energy, natural gas can make contributions to both environmental protection and economic prosperity, but the main obstacle is neither price nor supply, but the market and trade restrictions, as well as distorted pricing of alternative energy. It is evident that with adequate supply and declining prices in the first half of 2015, growth of natural gas demand slid. From 8.9% in 2014 to 1.4%. The national carbon-trading market that

China plans to establish in 2016 would help to partially alleviate this distortion, but the most important thing is promote the much needed reform in the power sector.

Energy security, especially of the oil and gas supply, has always been one of the major concerns of the Chinese government. This also to some extent explains the Chinese firm stance on the issue of the South China Sea. With clearer prospects for U.S. exports to the Asia-Pacific market, China and the U.S. would have common interests in safeguarding oil and gas supplies in this region. Even though oil is not mentioned in the “Sino-U.S. Joint Declaration on Climate Change,” coordinating the two countries’ oil policies, including in the evaluation of greenhouse-gas emissions from unconventional oils. Managing the consumption of its by-product, petroleum coke, requires institutionalizing cooperation and communication between the United States and China. This would ease Chinese concerns about energy security, contributing to the two countries’ common target of climate change, and encourage China’s participation in international energy governance.

Collaboration on clean technology, energy-sector reform, and energy security could provide new impetus to China’s economic transition, but also provide more support for the U.S. economic recovery, and at the same time contribute to the stability of the world’s economy and efforts in tackling climate change.

Professor Yan Xuetong, president of the management board of the Carnegie–Tsinghua Center for Global Policy, commented in July 2013 that, “providing public good to the international community is the foothold for a healthy competition between China and the United States.” Seventy years ago, China and the U.S. fought side by side during the anti-fascist war, but confined by different battlegrounds, direct cooperation was limited. Seventy years later, facing economic uncertainty and climate change that put the world’s prosperity and sustainability at great peril, the two countries have to work much more closely to provide much-needed public good for the world. This should be the essence of “Sino-U.S. new type of major-power relationship.”



Calming Cyber Nerves

In some ways, Xi's state visit was really a summit on cyber security, as allegations of spying and theft of national security information and commercial intellectual property have threatened to derail attempts to expand cooperation between the world's largest economies. The parallels with the nuclear age are obvious, and so is the mutual benefit of cyber detente.



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China President Xi Jinping's late September visit to the United States was both important and historic. Among other activities, he and first lady Peng Liyuan were welcomed to the White House with a 21-gun salute and a state dinner, the highest level of protocol that can be extended to visiting foreign leaders. As a matter of international respect and an indication of both status and rank, Xi's reception showed the strategic importance that the United States accords to maintaining strong, positive relations with China.

At the same time, the visit clearly and intentionally placed cyber issues at the very top of the bilateral agenda. In some ways, Xi's state visit was really a summit on cyber security, as allegations of spying and theft of national security information and commercial intellectual property have increasingly complicated bilateral relations. Just prior to the visit, in fact, the White House leaked news

that it was considering sanctions against Chinese nationals credibly accused of engaging in such activities. Sanctions were ultimately withheld, but the threat remains.

In the meantime, a battle has been joined for the hearts and minds of the private sector, which has been at the forefront of building the bilateral relationship. It has been the U.S. private sector which has pushed most aggressively for improved economic and commercial links, from permanent normal trade relations and China's WTO membership to liberalized technology transfer rules and open trade and investment regimes. The private sector has also maintained purposeful engagement in Washington that serves as a counterweight to the political passions that often create tension in the relationship, particularly during U.S. presidential-election cycles, working to maintain a pragmatic dialogue between the world's two largest economies.

Cheerleading has turned to complaining, however, as the private sector increasingly finds itself the target of forced technology transfer and cyber-enabled theft of intellectual property, allegedly from Chinese entities including the government. According to US China Business Council head John Frisbie, cyber issues may pose “the greatest threat to the bilateral relationship.” For its part, the United States government says that it does not engage in commercial espionage.

These issues are deeply felt, because they are critical drivers of commercial success.

Technological advantage over the years has given the United States an economic edge, but China is rapidly catching up, an unsettling vision given Washington’s preferred narrative of technological superiority. With this in mind, a state visit that did not directly address cyber-related issues would have been untenable.

As it happened, during Xi’s visit both countries committed to cooperation on cyber issues, maintaining a

positive tone at all times, eschewing the conduct or knowing support of cyber-enabled IP theft and agreeing to additional steps on cybersecurity and cybercrime, early-warning, and high-level consultations. Of course, implementation must now follow, and China’s record in living up to its international commitments has been spotty, but the fact remains that China has now publicly committed to forego commercial cyber-espionage against the United States. As technology increasingly drives economic development in addition to national security, competition in cyberspace is now firmly a part of the international-relations agenda. This is a breakthrough.

It is also a process. Several days prior to the state visit, Xi was in “the other Washington,” meeting in Seattle with technology CEO’s and other senior business leaders. The optics were revealing: Xi was in a hotbed of U.S. innovation and technology development seeking additional investment and collaboration, but was also looking to exchange views on more complicated issues such as compliance with



A nascent, government-to-government process is now in place for consultation and coordination on critical commercial issues.



a new national security law widely seen as anti-competitive. At issue is a requirement that all information systems be “secure and controllable,” with pressure on U.S. companies to pledge compliance, potentially risking personal consumer data, business-confidential information, and reputation. It’s the age-old dilemma: Market access is granted along with agreement to conform to local requirements and conditions. A full scale tech sector revolt was underway, threatening to undermine the state visit. Hence, Xi’s high-profile, carefully scripted program in Seattle that addressed but did not fully resolve the issues, which will only become more compelling as the United States and China continue to develop and compete. A nascent, government-to-government process is now in place for consultation and coordination on critical commercial issues. But this is just the beginning. Success will require the Chinese government not just to cease cyber-enabled commercial acquisition but also to identify and bring to justice independent and quasi-independent hackers who may be engaged in such activities. The same holds true for the United States.

Going beyond commercial relationship and proprietary intellectual property, the next step will be to engage in meaningful discussions toward cyber-détente between governments. The parallels with the nuclear age are obvious,

whereby two committed and sophisticated global security rivals eventually understood it to be in their mutual interests to forswear the further build-up of nuclear arsenals and to exist under a strategy of mutually assured destruction. In some ways a full scale cyber-attack would be as destructive, disruptive, and indiscriminate as a nuclear attack, without the concomitant loss of life. As the conduct of national security, commercial, and even daily personal affairs becomes increasingly networked through the Internet of Things, however, the threat posed by cyberwar increases exponentially. Establishing a robust, multilateral regime of cyber deterrence and restraint could be the best means to counter these emerging threats. As two of the more capable and interested parties, the United States and China should consider entering into negotiations leading to such a result.

President Xi’s visit to both “Washingtons” signaled China’s continued rise on the global stage. Now is the time to find the means to recognize and celebrate this fact while engaging directly with China to support, rather than undermine, security. The stakes are already high, and they get higher with every further day of delay.



The U.S. and China just held a dialogue on space, mostly in secret to avoid the sensationalist ire of politicians and pundits. Working cooperatively could enable scientists in both countries to do more with their limited funds, exchange data and scientific discovery, as well as improve Global Navigation Satellite Systems.

Found in Space: Cooperation



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Three remarkable space-related events recently occurred. On Sept 28, NASA announced flowing water had been discovered on Mars. The following week, the movie *The Martian* was released to an astounding 94% Rotten Tomatoes approval rating and box-office receipts topping \$55 million. And perhaps most remarkable of all, on Sept 28, the U.S. and China held the first U.S.-China Space Dialogue meeting in Beijing.

An imaging spectrometer on NASA's Mars Reconnaissance

Orbiter (MRO) provided strong – convincing – evidence that water intermittently flows on Mars. Usually circumspect scientists were near “giddy” at the announcement. The public was interested as well, though not surprisingly their interest focused as much on the Mars team member who plays in a death metal band and speculation about aliens as it did on the science. And then as if scripted, the movie *The Martian* was released, with Matt Damon's abandoned-astronaut character winning over audiences with his

wit, determination, and (spoiler alert) ingenuity in growing potatoes on Mars and rigging a spacecraft with a tarp to get himself home. But even with wit, determination and ingenuity he wouldn't have made it home were it not for assistance from – the Chinese.

This isn't the first time that China has snuck into a Hollywood blockbuster. A special version of Ironman 3 with extra scenes featuring a Chinese heartthrob was created for Chinese audiences. And astronaut Sandra Bullock was able to make her way home in the movie Gravity with the help of an unoccupied Chinese space station. Clearly, Hollywood is playing to the Chinese movie market. But in both movies, Gravity and The Martian, space catastrophes resulted in the United States and China working together. Though audiences weren't repelled by the idea of cooperation in either instance, it seems only "naïve" and "foolhardy" scriptwriters think such cooperation is possible, or desirable.

And maybe some people in the Obama Administration.

Plans for this recent U.S. China Dialogue on Civil Space was first

announced last June, consequent to the seventh round of the U.S.-China Strategic and Economic Dialogue. As online space-policy analyst Marcia Smith stated regarding the Sept 28 meeting, "details are scant." [1] Mainstream media coverage has been virtually non-existent. Most likely, flying under the radar has been okay with the U.S. State Department, which chaired the Beijing meeting along with the Chinese National Space Administration (CNSA).

Otherwise, critics would have undoubtedly trotted out their litany of reasons—ranging from human rights and freedom of religion to concerns, some valid and some overblown, about technology transfer—why the United States should scrap one of its most valuable policy tools, diplomacy, and not communicate with the Chinese regarding space. That's the kind of convoluted reasoning that resulted in a legislative ban since 2011 on bilateral cooperation cum communication between NASA and the Office of Science and Technology Policy (OSTP) with China. Careful to stay within Congressional guidelines, that legislation left it to the State Department to chair the recent Beijing meeting.

The increasing U.S. propensity, especially in conjunction with political campaigning, to equate diplomacy with appeasement and negotiation with weakness has not served the U.S. well in other parts of the world, and won't with China either.

The increasing U.S. propensity, especially in conjunction with political campaigning, to equate diplomacy with appeasement and negotiation with weakness has not served the U.S. well in other parts of the world, and won't with China either. The Obama Administration has apparently decided that with nothing to lose politically, it intends to make strategic and sometimes bold foreign policy moves before leaving office, in spite of obstructionist roadblocks: normalizing relations with Cuba, negotiating a nuclear treaty with Iran, and talking with the Chinese about space among them. It is ironic that "talking" has become a bold policy move.



According to the DOS media note on the meeting, [2] the broad intent of the meeting was greater transparency, initially including an exchange of information on each other's space policies. The importance of that simple objective cannot be overstated. The Chinese -- Asian -- cultural propensity toward opaqueness has resulted in the U.S. assessing all things space-related

done by China from a worst-case scenario perspective. The American cultural attribute of everybody -- regardless of standing or knowledge -- having an opinion on every subject can result in the Chinese believing that anything said in the New York Times or on Fox News is official U.S. policy. Clarity can serve both parties well.

Apparently also, according to the media note, space debris and satellite collision avoidance were discussed, in acknowledgement that those issues cannot be handled solely on a national basis and are critical to maintaining the sustainability of the space environment. Since the United States has more assets in space and is more dependent on those space assets in both civil and military operations than any other country, it behooves the

U.S. to pursue all potentially valuable avenues available to protect the space environment. It is in U.S. interests. Given the increasing number of Chinese assets in space, sustainability of the space environment is in Chinese interests as well. Countries cooperate where both have a vested interest.

Other topics that were discussed

in conjunction with potential cooperation were civil Earth-observation activities, space sciences, space weather and the civil Global Navigation Satellite System. Beyond the general benefits that flow to the U.S. from cooperation – including learning Chinese standard operating procedures in decision making and operations, establishing an internal Chinese constituency to argue against aggressive Chinese actions that threaten cooperative programs by creating a vested interest in continuance, and getting a closer look at Chinese capabilities – cooperation in each of these areas offers the U.S. more in benefits than associated risks.

Working together on civilian-Earth observation activities would likely involve sharing data on complex Earth-system processes relevant to everyone on the planet. There are frequently data gaps in the models designed to address these complex processes, gaps that can be closed by sharing data. Better models would yield positive benefits to both countries in fields like disaster management, environmental studies, coastal and marine planning, and sustainable land use. Everybody wins.

Space-science cooperation has long been discussed as potentially valuable and viable for two reasons. First, it can be an area of cooperation where technology-transfer concerns can be minimized. Although it would likely begin only with data exchanges, ideally data exchanges could lead to more extensive projects so that Americans can learn more

about Chinese decision making and foster positive constituencies within China. Further, space scientists in both countries are notoriously like stepchildren when it comes to funding allocations. Working cooperatively could enable scientists in both countries to do more with their limited funds. One area of space science with practical application is space weather – being able to anticipate solar flares and geomagnetic storms that are potentially damaging to satellites in orbit and negatively affecting ground facilities and operations, and thereby be able to protect against those effects. Space weather “predictions” are based on fundamental scientific research on solar-terrestrial physics.

Finally, discussions on civil Global Navigation Satellite Systems (GNSS) focus on navigation satellite systems with global coverage, including the U.S. Global Positioning Satellites (GPS), the Russian GLONASS system, and the expanding Chinese BeiDou system. It is in U.S. interests to assure that China integrates BeiDou with other systems rather than having BeiDou incompatible with other systems. If China were to integrate only BeiDou into the myriad of commercial products that utilize GNSS and that China produces, thereby requiring a different receiver than currently used by GPS, that would wield significant negative economic impacts on the U.S. Additionally, non-integration could also create a more chaotic environment for GNSS use.

Fostering cooperation is an integral part of the Space Act that created NASA.

Therefore, the United States is not merely doing China a favor by participating in these talks or by considering expanded areas of space cooperation, as is sometimes characterized. It is the United States acting in its own best interest. While ideally the U.S. could tie space cooperation to other contentious issues between the U.S. and China – cyber attacks, for example – that is unlikely to happen. Expecting and waiting for that unlikely link to be made allows critical space issues to go unaddressed.

There are some fundamental questions about the U.S.-China relationship that might prove useful in guiding future policy. Does it support or go against U.S. interests to keep its friends close and enemies closer? If the answer to that is “yes,” then either way, the U.S. should pursue expanded opportunities to work with China in space. Is in the best interests of the United States to have China stable, or imploding? If the answer is stable, then we inherently must learn to work with China in areas of mutual interest. Is the sustainability of the space environment in the interests of the United States? If it is, there is no choice but to work with China on a variety of space issues. A second meeting is scheduled for 2016 in Washington, D.C. Hopefully real progress will be made in advancing

cooperation in at least one of the areas initially broached at the recent September meeting.

Space cooperation between the U.S. and the Soviet Union was judiciously used as a mechanism to build broader areas of trust during the Cold War, and Post-Cold War years. The United States knows how to successfully conduct space diplomacy. It is an aberration that today it has to be done in secret so as not to draw the sensationalist ire of politicians and pundits. Fostering cooperation is an integral part of the Space Act that created NASA. Ironically, perhaps through the continued, unintended help of Hollywood the public will recognize the wisdom of allowing NASA, OSTP and the State Department to do their jobs, and begin to take an active role in demanding inclusive space cooperation.

[1] “U.S., China Hold First Civil Space Dialogue Meeting,” September 30, 2015. <http://www.spacepolicyonline.com/news/u-s-china-hold-first-civil-space-dialogue-meeting>

[2] <http://www.state.gov/r/pa/prs/ps/2015/09/247394.htm>

China Sees a Chance in TPP to Stimulate Reforms

Because existing trade terms mean 80% of TPP members' exports to the U.S. are already duty-free while even a bigger percentage of China's manufactured goods enjoy that status, the agreement's bottom-line impact on trade is negligible for now. The deal is more about who gets to write the long-term rules of global governance, which for China is both a challenge and an opportunity to reshape its economy in the direction it was going anyway.

The recent conclusion of the Trans-Pacific Partnership (TPP) under the auspices of the United States has touched off a heated debate about its impact on China's external trade and investment. Overall, the TPP is both a challenge and opportunity for China, as it comes at a critical moment when China tries to engage more deeply and widely in global governance.

The potential short-term impact of the TPP on China's trade and economy as a whole is almost negligible, while the medium- and long-term impact depends on how China reacts to the TPP and handles its economic "new normal." The TPP could even provide impetus for China's efforts to deepen its economic reforms.

Perhaps because the stakes are

simply too great to contemplate, the world is no longer being haunted by the specter of wars among major powers. The remaining competition among major powers is mostly relegated to global rule-making or global governance. The TPP is precisely one such example: It is about who will lead in global economic rule-making.

On surface the TPP is all about trade and investment, but more broadly, it is a smart move by the U.S. to set a higher bar for China in global trade and investment in the face of a more diverse picture of global governance. The TPP has thus become an economic instrument to carry out the "Asia-Pacific Rebalance," brimming with geo-political implications. Through the partnership, the U.S. hopes to regain control of global trade



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rule-making as it has become uneasy about the growing influence of developing nations represented by China in such institutions as G20, WTO, and APEC. Fortunately the TPP is only one of over 260 FTAs currently in existence; it can't be everything at the same time.

From a purely economic perspective, when some economies form a tax union or FTA, there will be "trade creation" and "trade transfer." Only the latter will be detrimental to outsiders, as trade barriers are reduced or eliminated within the grouping. So how much trade transfer will occur with TPP? Actually, not much because 80% of TPP members' exports to the U.S. are already duty-free while even a bigger percentage of China's manufactured goods enjoy that status. So by and large, the TPP tax change mostly affects agricultural produce from the U.S., Japan, Canada and Australia.

In addition, TPP members such as Australia, New Zealand, Peru and Chile have signed bilateral trade agreements with China. The China-ASEAN FTA covers Vietnam, Singapore, Brunei, and Malaysia. All of this greatly reduces the TPP's negative impact on China. Another relevant point: Apart from NAFTA, American trade with TPP members amounts to a bit over \$400 billion yearly while its annual trade with China tops \$600 billion. That accounts for 10% of its trade as compared with 4.2% for Japan.

Most TPP members, except Japan and Australia, enjoy large trade surpluses with

China. As long as China keeps growing under the "new normal" and with its new industrial base having consolidated in the last few decades, China will get an even greater share of the world market once the global economy fully recovers.

The TPP is precisely one such example: It is about who will lead in global economic rule-making.

In sum, the TPP is more a psychological threat of "crying wolf." It will likely have little impact on China's foreign trade next year.

The TPP will mainly affect China's medium and long-term domestic economic policy reforms. As a regional FTA, the TPP puts more emphasis on "within border" policies and rules associated with trade like IPR protection, labor standards, environmental protection, and SOEs than "on border" trade barriers.

Many of the rules the TPP covers certainly fall within the purview of further reforms in China. They seem pretty difficult to achieve in the short term, but not too much so as to be unreachable. TPP members include advanced and less advanced economies and many face the same challenges as China does. Take SOEs for instance. 40% of Vietnamese GDP is contributed by its SOEs, while Singapore and Malaysia have similar percentages. If they can cope with TPP rules on SOEs,

China should have no major problems either.

Many TPP rules represent current trends in global trade and eventually will be accepted by the world. These new standards might bring great challenges to China's efforts to upgrade its industries, but in the end they could also be opportunities for China to pursue further economic reforms in the coming years. China must play its due part in the global rule-making in free trade and investment, instead of being led.

China will not be able to join TPP because the U.S. and Japan are opposed to it, although China and the U.S. say both are open to China membership. For that, China needs to be cool-headed and take the following steps among other things to meet the challenge posed by TPP.

The first step is to deepen reforms already in the pipeline. It is advisable to quicken the pace of four major domestic FTA experiments covering Guangdong, Fujian, Shanghai and Tianjin. A great deal of

innovations will occur in these areas and they should be quickly copied nation-wide. That will lay a good foundation for future moves of either joining TPP, or having TPP merge with other regional FTAs. We are entering a new era of global governance and remolding of trade rules, which should be viewed as a good opportunity for China rather than a threat in globalization.

As China engages ever further in global governance, more new rules will present themselves and it ought to be ready for such scenarios. China should further reform its financial system and reduce costs for funding the real economy in order to elevate industrial competitiveness. It should also deepen reforms of SOEs and develop better mixed-ownership in enterprises to expand foreign trade. It needs to continue improving labor conditions so that a balance of decent work and better ecological and environmental effects can occur. The TPP is more about global governance, and should be treated as such.



The Trans-Pacific Partnership (TPP) is a proposed trade agreement among 12 Pacific Rim countries, including the U.S. and Japan, with the purported goals of lowering trade barriers and promoting investment.

The second step is to offset any negative consequences of the TPP by proactively pursuing other regional initiatives, given the fact that China will assume the rotating chair of the G20 in 2016, and enjoys great influence in regional institutions like APEC.

China should more vigorously pursue FTAAP negotiations, quicken the pace of a China-Japan-South Korea East Asia FTA, and conclude negotiations of the RCEP by the end of 2016.

The third step is to put the One Belt, One Road (OBOR) initiative into practice as quickly as possible. Efforts should be made to pursue policy dialogues with countries along OBOR to adapt developmental strategies with one another. Major partners like Indonesia, Thailand, Malaysia and Pakistan should be consulted first. Such new financial institutions as

the Asia Infrastructure Investment Bank (AIIB) and Silk Road Fund should be brought into full play—based on internationally accepted rules—to boost cooperation on redistribution of production capacities. President Xi Jinping’s visit to the UK provides further impetus for greater European inputs into the OBOR initiative.

The fourth step is to manage China-U.S. relations in a way that will help OBOR rather than impede its implementation. The recent successful state visit to the U.S. by President Xi demonstrates that the U.S. is better prepared now to accept OBOR as a platform for bilateral cooperation. That is certainly good news for all involved to shed the TPP of “the geo-political coat” that it should not have worn in the first place.

OBOR calls for the creation of an economic land belt that includes countries on the original Silk Road through Central Asia, West Asia, the Middle East and Europe, as well as a maritime route that connects China’s coastal regions to Southeast Asia, Africa and Europe. China initiated OBOR to further integrate its economy with the world and boost its influence globally.





Freer RMB Good for Global Economy

As China allows more market influence to determine the value of the RMB, the exchange rate will become more volatile. Allowing the market to determine the value of the yuan is precisely what the West has long sought, and it will serve global interests, whether China's currency rises or falls.



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On August 11, the People's Bank of China (PBOC) announced that, in the future, the offer prices reported to it by market determiners should be based on the closing parity rate of the market on the previous day. At the same time, the China's central bank lowered the central parity rate by 1.9 percent.

The depreciation sent a shockwave around the globe. Many foreign commentators feared that the bank has embarked on a course of devaluation to boost China's exports, which in turn could set off a new round of currency wars.

This worry is understandable but unwarranted. As pointed out by the vice-governor of the PBOC, Yi Gang, “We do not need to devalue the RMB to promote exports.” There are many reasons to believe this is true. First, China knows well that currency wars are self-defeating. During the Asian Financial Crisis, China’s economic situation was much worse, but China resisted the temptation to devalue the RMB. Even without resorting to devaluation, China was able to come out of the crisis unscathed. Second, China is very serious about shifting the growth mode from investment-export driven to domestic consumption driven. China is still running large trade surplus; the negative impact on China’s economy from a further narrowing in trade surplus can and should be offset by an increase in domestic demand in general, and domestic consumption in particular. Third, as the largest trade nation in the world, China’s share of exports in global exports has already surpassed 12 per cent. It will be very difficult indeed for China to expand its share further without worsening

its terms of trade greatly. Fourth, due to China’s special position in processing trade and global value chains of production, it is difficult

As a result, in the foreseeable future, the RMB is more likely to depreciate than to appreciate.

to assess how effective devaluation would be in increasing China’s trade surplus. Finally, China is not only a trading nation but also a nation with huge overseas financial assets and liabilities. The foreign borrowing from non-financial Chinese corporations’ can be as high as \$1 trillion. Any large devaluation will correspondingly increase the Chinese firms’ debt burden in RMB terms, which will lead to a large number of bankruptcies, and a dramatic increase in nonperforming loans. Hence, China’s avoidance of getting involved in competitive devaluation is not only the responsibility of China as a major global power, but also in its own interest.

As pointed out by the vice-governor of the PBOC, Yi Gang, “We do not need to devalue the RMB to promote exports.” There are many reasons to believe this is true.

For the rest of world, being able to cheer China on to relax the RMB exchange rate, while watching RMB depreciation in a quiet manner, is an equally serious challenge.

In my view, the purpose behind the bank's Aug 11 action is twofold. First, loosening PBOC's grip on the RMB exchange rate allows the market to play a more important role in determining the exchange rate. Second, it narrows the gap between the official exchange rate and the exchange rate implied by market supply and demand. Since the turn of the century, the United States and other major industrial countries have been pushing China to allow the market to determine the RMB exchange-rate regime. Now that China has made an effort towards this direction, resulting in RMB depreciation, is it legitimate for them to complain?

Now, China is more willing than before to carry out such a reform for various reasons. The Aug 11 depreciation is an important landmark in China's long-overdue reform of its exchange-rate regime. However, I guess, due to the fact that the RMB depreciation pressure is so strong, if the PBOC let the market makers determine the central parity rate without intervention, the original planned one-off adjustment of the RMB exchange rate could morph into a rout, which is not a prospect the PBOC is ready to face. As a result, after testing the water just for two days, the PBOC retreated and told the market that the devaluation was just 3 percent and no more. Because the PBOC has enough ammunition to stabilize the exchange rate and the market also believes so, the exchange rate rebounded duly and calm returned to the market.

The episode has ended. However, the dramatic fall in the RMB exchange rate from Aug 11 to 13 shows that the era of one-way appreciation of the RMB has ended. In the future, because of China's capital account liberalization and RMB internationalization, the RMB exchange rate will become more volatile. It is very likely that because growth of the Chinese economy will continue to weaken, the PBOC will have to loosen monetary policy further. At the same time, the U.S. Federal Reserve will exit quantitative easing gradually. As a result, in the foreseeable future, the RMB is more likely to depreciate than to appreciate.

For the Chinese monetary authorities, how to allow the market to determine the RMB exchange rate, while preventing the depreciation from sparking a rout, is a serious challenge. For the rest of world, being able to cheer China on to relax the RMB exchange rate, while watching RMB depreciation in a quiet manner, is an equally serious challenge. Hopefully, neither side will fail the tests.



No Hard Landing in Chinese Economy

Stock market volatilities and weak economic data have led to mounting pessimism about China's economy, fueling fear of a hard landing. However, the effect of "China shock" is psychological and temporary. As consumption will contribute a stable 4% and investment at least 2% China's total GDP growth will be above 6%.

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Since the start of August, the stock-market plunge, the RMB's moderate devaluation against the dollar, and the recent weak economic data have led to mounting pessimism about the Chinese economy in the world. Some experts and media ascribed the global market's panic to the Chinese stock-market plunge and the continuous depreciation in many emerging-market currencies to RMB devaluation. A prevailing saying goes that "When China sneezes, the world catches cold." Highlighting the new concern, an article in the Financial Times in late August even asked if "The China Age" is over.

The Federal Reserve Bank decided not to raise interest rates on Sept 17, based partly on the international financial situation including the China factor.

However, other developments during the first half of September have provided more food for thought. There has been a mild stabilization and even a pick-up in the U.S. and European stock markets, although the Chinese stock market has been wavering. The RMB-dollar exchange rate has remained remarkably stable after 4% depreciation in mid-August.

A closer look at the fundamentals of the Chinese economy will provide some new perspective.

Total GDP growth rate will be above 6%, which is considerably higher than any range of "hard landing" (GDP growth rate under 4%), and will remain a medium-high growth rate among all the world leading economies.

The Chinese Stock-Market Plunge Does not Reflect the Economic Fundamentals

People tend to raise alarms about the Chinese stock plunge from its June peak, but few mention the sharp rise that preceded it. The Shanghai composite index barely stood at 3,005 on September 15, 41.8% down from its peak of 5,166.35 on June 12th. However, exactly 12 months earlier, the index was only 2,051.71 (June 12, 2014). There was a frenzied rise of 151.8% over the previous 12 months! Media in the West even neglected it — only mentioning that \$5 trillion evaporated in the world stock markets in August. They even failed to mention that \$4 trillion evaporated in Chinese stock markets alone. Nonetheless, it was only out of the \$6 trillion that was added during the previous 12 months' dramatic rise. At 3,005, the market was still 46.4% up over the last 15 months.

The mad, irrational stock boom during the 12 months before June 2015 had led to an exceptionally high PE (90.42 on average), or serious bubble, that could only end in a bust. However, during the whole 15 months of boom and bust, the macro economic data kept sliding. GDP growth decelerated from 7.5% in H1, 2014, to 7.4% in H2, 2014, and to 7.0% in H2, 2015 (Note: Downside trend is more obvious even during the stock boom). Hence, the stock-market index's sharp fall does not indicate any big trouble in the Chinese macro economy, although both irrational booms and sudden busts are damaging.

6-7% Growth in China Achievable

The continuing downside trend in the Chinese economy has been caused by the changes in three basic driving forces: consumption, fixed investment, and net exports, with investment playing an increasingly weaker role and net exports dwindling.

The double-digit economic growth before 2011 was primarily pushed by heavy investment, which contributed 7.0 percentage points to the GDP growth of 10.6% in 2010. During that year, the investment ratio (fixed investment volume as a percentage of GDP) was 61.8%. Since then, the ratio has kept rising, hitting 76.5% in 2013 and 80.8% in 2014. However, it contributed only 4.2 percentage points to GDP growth in 2013 and only 3.6 percentage points in 2014. During the first half of 2015, the ratio was slightly higher than in 2014, but contributed less than 3 percentage points. Why? The declining efficiency or fringe benefit due to excess investment. Therefore, investment's contribution to GDP has shed 2-3 percentage points.

Net exports, which normally contributed 1-2 percentage points to GDP growth during the double-digit growth period, have made roughly zero contribution over the recent years.

As a result, the only leading force driving GDP growth is consumption, which has remained stable, contributing 3.7, 3.7, and 4.2 percentage points to GDP growth in 2013, 2014, and H1 of 2015.

It can be expected that consumption will contribute a stable 4 percentage points to GDP growth over the next few years. Investment, due to its huge size and more efficient investment from the private sector, could contribute at least 2 percentage points to GDP growth. Assuming that net exports will continue to make zero contribution, total GDP growth rate will be above 6%, which is considerably higher than any range of “hard landing” (GDP growth rate under 4%), and will remain a medium-high growth rate among all the world leading economies.

Dr. Simon Baptist, chief economist of the Economist Intelligence Unit (EIU), estimated on Sept 10 that total world GDP will add \$2,159.6 billion in 2016, with China contributing \$ 901 billion, accounting for 41.7% of world economic growth, and the U.S. contributing \$619 billion, accounting for 30.5%. China will still make the largest contribution to world economic growth.

China is Not the Fundamental Reason for the American Stock Market Fall

“China shock” did influence the U.S. and European stock markets last month. However, the repercussion was mostly psychological and temporary: With time passing by, their own market fundamentals dominate. During the first half of September, the U.S. and European markets have been rising steadily, although the Chinese stock markets are still struggling.

First, the Chinese and American stock markets have followed different trajectories. The Chinese stock market plunge started in mid-June, with the Shanghai composite index breaking the 4,000 barrier on July 25 (falling from 5,166.35 on June 12). The Dow Jones Industrial Average, on the other hand, remained resilient at 17,690.46 on July 31, marginally lower from 18,010.68 on May 29. It started slumping from Aug 20, more than two months later. The Shanghai composite index fell below 3,000 on Aug 25, and

has hovered around that level ever since. The DJIA, however, after hitting 15,370, recovered gradually. On Sept 17, it closed at 16,774.74, 9.1% up from the low.

Second, the American stock market has its own bubbles. Above 18,000, DJIA was approximately 40% higher than it was at the end of 2012, while actual GDP had grown by 7% during this period. Studies show that S&P 500 PE was already 27.2 by early August, compared to the historic average of 16.6. S&P 500 PE was only higher in 1929, 2000 and 2007, all followed with a stock plunge. Professor Robert Schiller of Yale University, a Nobel laureate, said recently that his study had found apparent stock bubbles. Mr. Wolfgang Schauble, the German finance minister, made a similar warning on Sept 11.

Third, the prospect of a Fed rate hike, pending but undated, was enough to cap the stock market. On Oct 19, 1987, when new Fed chairman Alan Greenspan raised the federal rate by a drastic 2%, the stock market crashed immediately, with the DJIA falling by 22.5% in a single trading day, known as “Black Monday”. Nonetheless, the real economy was not that hurt. GDP in 1987 grew by 3.5% that year and accelerated to 4.2% in 1988. The recent US stock-market fall was actually a gradual response and pre-digestion of the pending Fed rate hike. The Fed decided on Sept 17 not to raise the federal rate, thus giving the market further breathing room. However, the initial



response was a slight fall before closing, because the decision aggravated the market's pessimistic sentiment on the economy.

Dollar Strength, Not "Currency War"

The moderate depreciation of RMB to the dollar that started on Aug 11 lasted only three trading days, with a slight rebound since then, resulting in a net 3.7% fall. However, the RMB only depreciated against the dollar, not a basket of major currencies. The basic reason for the depreciation is apparently the dollar's strength.

Before Aug 11, major Asian currencies had already depreciated drastically to the dollar. According to a recent EIU study, during the 12 months prior to July, the Australian dollar fell by 16% to the dollar, the Japanese yen fell by 15%, followed by the currencies of New Zealand (-12%), Malaysia (-11%), Myanmar (-10%), Indonesia (-9%), Singapore (-7%), South Korea(-5%), India and Vietnam (-4% each), Sri Lanka, Thailand, Taiwan (-2% each), the Philippines and Cambodia (-1% each). Only the RMB and the Hong Kong dollar remained unchanged against the US dollar. During the same period, the RMB appreciated by 19% to the euro. Therefore, the RMB is still stronger than most other Asian currencies along with the euro, even after the recent depreciation.

During the month from Aug 14 to Sept 11, while the RMB rose slightly against the dollar, most other Asian currencies' and the Brazilian real's depreciation accelerated. The Indian rupee fell by 2.1%, almost the same as from Aug 11-14 (off 2.0%). The Brazilian real fell by 11.9% (up 0.2%). The Malaysia ringgit fell by 5.8% (off 3.9%). The South African rand fell by 6.4% (off 1.3%). On September 17th, when the Fed decided not to raise the interest rate, the emerging economies' currencies immediately rose to the dollar. Again, it shows that the basic reason for their fall has been the dollar's strength, instead of the RMB's slide. No currency war has been triggered by

China.

Emerging Economies' Difficulties Should be Addressed Globally

As China's import demand has been contracting, China has been repeatedly blamed for the world commodity prices' fall and economic difficulties by a number of resource-dependent emerging economies. This is not true.

According to China's official customs data, the value of Chinese imports fell by 14.3% over a year ago, or a net fall of \$ 185.88 billion. The largest fall came from crude oil, off \$ 62.52 billion, or 33.6% of the total fall. Import quantity of crude oil, actually increased by 9.8% over a year ago, reaching 220.67 million tons. The only reason behind the sharp fall in oil import value is the world oil price plunge, apparently not caused by China. Iron ore's import value also fell by \$ 29.17 billion. However, there was virtually no fall in import quantity (off 0.2%). Zambia, with 70% of foreign-exchange income depending on copper-ore export, is currently in serious difficulty as the world copper price keeps slumping. China, on the other hand, increased its copper-ore imports by 12% during the first eight months of the year. Again, China is not the primary reason for the world copper-price fall.

The continuous fall in world energy and commodities is a global phenomenon that should be addressed by concerted efforts of all countries. With an expected mild rebound by the end of the year and beyond, it is likely that China's imports will gradually pick up, thus contributing more to the world commodities demand recovery.

About China-United States Exchange Foundation

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China-US Focus is the only open-platform where Chinese and American thought leaders can openly express their views on the myriad issues that face the two nations, thus promoting communication and understanding between the peoples of China and the United States.

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