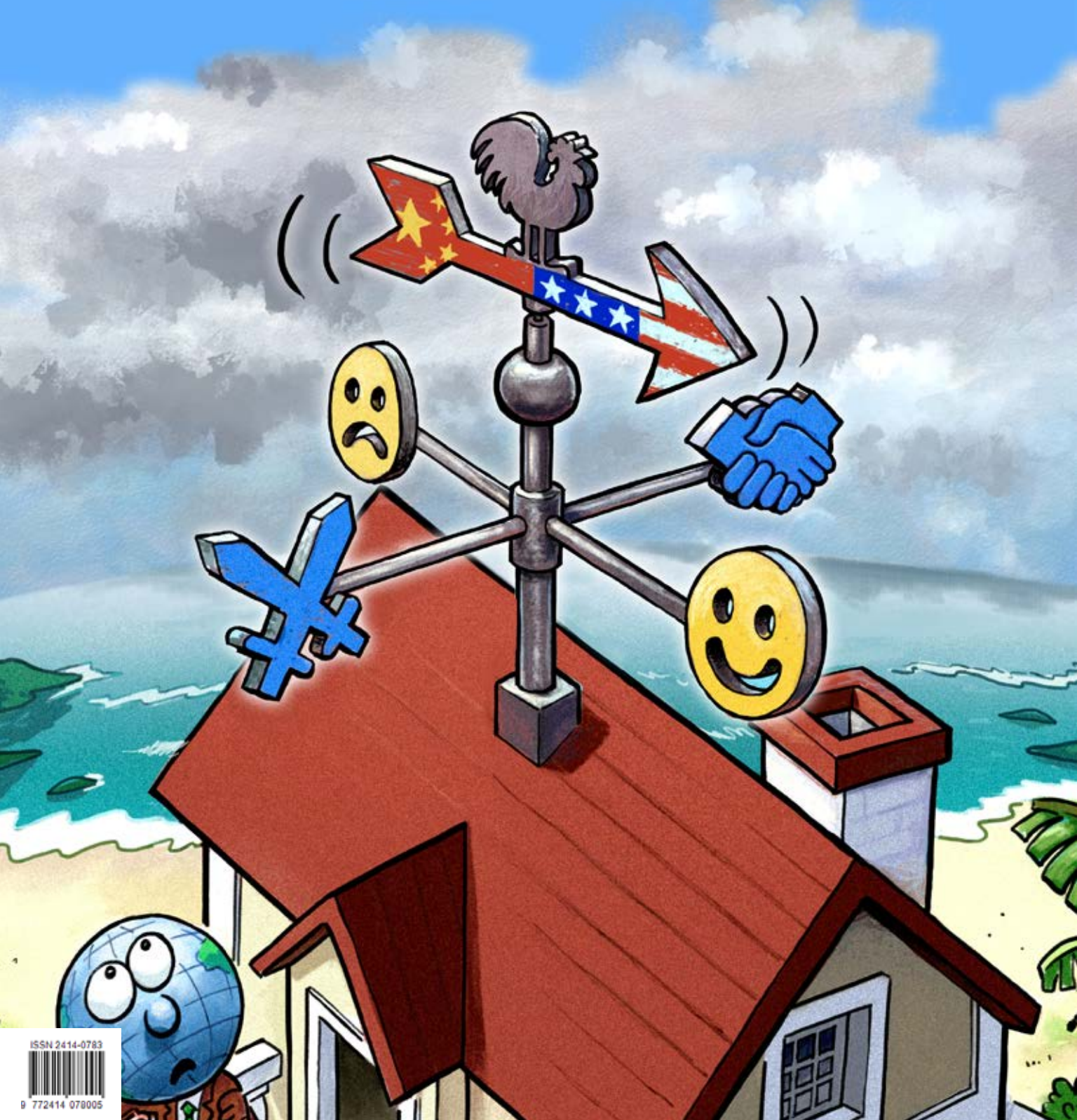


## A Change in the Winds?



# CHINA<sup>US</sup> Focus

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### The Best and the Worst of Times

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# Editor's Note

Zhang Ping

## China-U.S. Ties Begin to Smooth Out

Despite concerns that relations between China and the U.S. might get tougher after Trump takes office, more signs indicate that the bilateral ties are tilting toward a steadier path.

Both Beijing and Washington are said to be busy preparing for a meeting in early April, possibly at Mar-a-Lago in Florida, between President Xi Jinping and President Trump. It's rare for a sitting U.S. president to meet so early in his presidency with China's top leader.

That is a welcome twist. In the early days since taking office, Trump surprised many with his remarks on Taiwan. He continued his antagonistic campaign rhetoric on trade and other issues concerning China.

Fortunately, China didn't overreact. Through quiet diplomacy and acting in calm confidence, China instead sought a positive tone. The phone call between Xi and Trump on Feb 10 was pivotal in avoiding a hard landing in ties after Trump backtracked on his remarks challenging the one-China policy.

Uncertainties remain – frictions over trade and investment reciprocity, geopolitical rivalry in the Asia-Pacific, and lingering suspicions over each other's long-term strategic intentions are unknowns that can still set the relationship back.

Yet shared interests and the pressing need for forging partnerships to deal with regional and global flashpoints and issues dictate that the

two countries need to cooperate instead of being at loggerheads with each other.

This view is shared by our contributor He Yafei, who outlines why the world can expect China-US ties to move ahead steadily.

For this issue, we add a dose of history by printing a piece by our Chinese-American contributor Don M. Tow on Anson Burlingame, a U.S. diplomat to imperial China in the 1860s, who later served as China's envoy to the U.S. and to European powers.

Harvard researcher Patrick Mendis discusses the aftermath of the U.S. withdrawal from TPP, questioning if Trump's "Make America Great Again" could eventually leave the U.S. less relevant in the Asia-Pacific region.

Three articles are about the recent developments on the Korean Peninsula, including one by Sampson Oppedisano, who takes stock of President Trump's options in dealing with North Korea, and another by Yale scholar Xu Duo, who cautions against using economic sanctions to punish South Korea for going along with the U.S. in installing THAAD anti-missile system.



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# China This Week

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# The Best and the Worst of Times

Common strategic interests of both countries require the U.S. and China to contribute to a new security framework in Asia-Pacific, by working together towards a better security arrangement for the region. Over-reliance on military alliances targeting third parties cannot replace efforts to provide adequate security for all.

Barely two months into the Trump Administration, the world has already witnessed its fair share of surprises in American foreign policy. Worries about the deteriorating state of the China-US relationship have proliferated with the sobering reality that the most important bilateral relationship of the 21st century is at stake, affecting the long-term interests of both nations and the prospects for world peace and global economic growth.

Despite rising pessimism and worries around the China-US relationship, there have been some strong signs in bilateral communications and consultations of late, which offer hope for stability. As President Xi recently noted in his Davos speech, this is the best of times and the worst of times. The same certainly goes for China-US relationship, as it is now facing both great opportunities and serious challenges.



**He Yafei**

*Former Vice Minister,  
State Council Office of  
Overseas Chinese Affairs*



*Chinese President Xi Jinping met with US Secretary of State Rex Tillerson on March 19 in Beijing. Both pledge cooperation over “regional hotspots”. (Photo: Xinhua)*

The most significant event to date has been the phone conversation between Presidents Xi Jinping and Donald Trump on the 20th of February, when both leaders reaffirmed their determination to increase cooperation between the two countries on the basis of “no conflict, no confrontation, mutual respect and win-win through cooperation.” Most importantly, President Trump stressed that his administration will continue to adhere to the “One China Policy.” These positive pronouncements have been again and again echoed during the recent meeting in Washington between President Trump and Chinese State Councilor Yang Jiechi as well as during the first visit to China by Secretary of State Rex Tillerson. It is widely noted that Mr. Tillerson’s visit to Beijing has reinforced the signal that China and the US are busy preparing a summit between the two Presidents as early as possible and “cooperation is the only correct choice for two major powers” in the next half century. This signal is not lost to the expectant world that this most important relationship will continue to move ahead steadily.

Admittedly, Trump’s China policy, as with his other policies, is still evolving and will take some time to take shape, but the basic realizations and policies for the future are already

beginning to emerge.

One of Trump’s first realizations is the fundamental understanding that the U.S. and China, the two major powers of the world today, need cooperation, not confrontation, the importance of which can’t be over emphasized. There are many spaces where the two nations’ interests converge or remain fairly close to each other, especially in maintaining peace in Asia and the world at large and promoting global economic growth.

The second is that economic cooperation and trade frictions will probably simultaneously increase as the new administration begins to focus on deriving greater economic benefits from trade through “buy American and hire American.”

The third realization is that some adjustments will have to be made in global governance by both countries to accommodate the changing tides of globalization, as well as the reprioritizing in America’s positions in certain fields of global governance such as climate change.

While the initial ideological confrontations might have subsided temporarily in bilateral dealings, eventually they will resurface. Geopolitical entanglements will loom larger as the Trump Administration

*Geopolitical entanglements will loom larger as the Trump Administration continues the “rebalance” in Asia-Pacific by strengthening military capability and its physical deployment in the region.*



*American companies in China profit greatly from the current bilateral trade, including supplying components to those final products “made in China”. They share a big chunk of the surplus.*

continues the “rebalance” in Asia-Pacific by strengthening military capability and its physical deployment in the region.

Regional security will therefore become more complex and risky as the U.S. begins to deploy the THAAD missile defense system in South Korea and as it encourages Japan and other allies to continue on their courses of possible collision with China. What strategic consensus both can reach on such core issues, to a large extent, will determine whether the two countries are capable of avoiding falling into “Thucydides Trap.” The reality is that, as mentioned by President Xi, the Pacific is spacious enough for both the U.S. and China to prosper and peacefully co-exist.

Trade and economic interdependence have been the bedrock of China-US relations for decades, benefitting both nations.

That exact interdependence puts Trump’s “America First” policy into perspective. Before Trump decides how to reduce the U.S. trade deficit with China, he must first realize where China’s surplus actually goes. American companies in China profit greatly from the current bilateral trade, including supplying components to those final products “made in China”. They share a big chunk of the surplus.

The same goes for “lost American jobs”. According to research done by both American and Chinese economists, over 80% of that loss is a direct result of technological innovations. One suggestion to reduce the trade deficit is for the U.S. to expand and increase its exports to China by, among other things, selling surplus shale gas and oil to China and lifting bans on sales of some of its dual-use high-tech goods to China. From the above we can

*One suggestion to reduce the trade deficit is for the U.S. to expand and increase its exports to China by, among other things, selling surplus shale gas and oil to China and lifting bans on sales of some of its dual-use high-tech goods to China.*

*Only new cooperative and collective security arrangements will do the job.*

come to one conclusion that some adjustments might be necessary and inevitable, but the overall direction of economic cooperation and two-way free trade and investments must be kept intact.

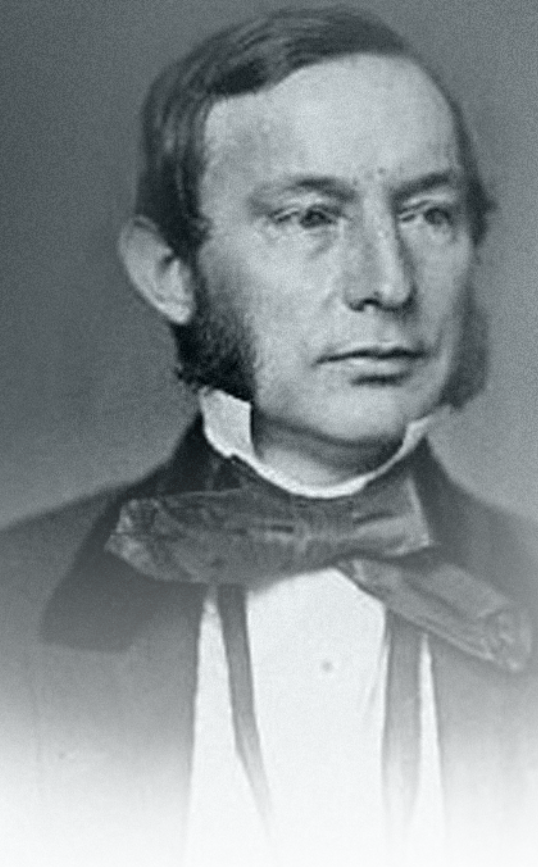
From the perspective of common strategic interests of both countries, it falls on the U.S. and China to contribute to a new security framework in Asia-Pacific, by working together towards a better security arrangement for the region. Over-reliance on military alliances targeting third parties cannot replace efforts to provide adequate security for all. Only new cooperative and collective security arrangements will do the job.

New security concepts proposed by China should be given more serious consideration. Within this framework, the ability to defuse a nuclear crisis and rising tensions on the Korean Peninsula is of paramount importance to both countries. Any thinking and actions towards possible “surgical strikes” on DPRK facilities would light the fuse for war. China will not accept a nuclear Korean Peninsula, nor condone any action that will lead to another war. By the same logic, the deployment of the THAAD missile defense system in South Korea is completely unacceptable to China. The U.S. and the ROK should

reconsider such a reckless move that will undermine the fragile strategic balance in the region. Both nations need to work closely and continue to seek a proper solution through peaceful political negotiation.

As major powers, the U.S. and China have special responsibilities, as articulated in the United Nations Charter, to maintain world peace and security. In today’s era of globalization, such responsibilities should also include confronting economic and social challenges, for which a cooperative relationship based on shared interests between the two is indispensable.

Anson Burlingame (1820-1870)



# U.S.-China Relationship Can Use Another Anson Burlingame

Tow traces a history of U.S.-China foreign relations, beginning in the 1860s to today, focusing on a policy he calls “surround/isolate/weaken.” The reason that policy toward China of the past 65-plus-years hasn’t worked is because it is based on “might makes right”, and not based on understanding, fair play, and win-win solutions. Anson Burlingame recognized about 150 years ago that, in the long run, the best interests of the U.S. and the American people are best served by a China policy based on equality of nations.



**Don M. Tow**

*President,  
New Jersey Alliance for  
Learning and Preserving the  
History of WWII in Asia*

## Who was Anson Burlingame?

Anson Burlingame, a name of which most people have probably never heard, was a unique diplomat. He was appointed by President Abraham Lincoln as U.S. Ambassador to China in 1861-1867. Then, China appointed him as China’s Ambassador to All the Treaty Powers, including the U.S., in 1867. He served in that role until 1870, when he caught pneumonia on a mission to Russia and died at the early age of 49 in St. Petersburg.

The middle of the 19th century was a period where China

was forced to sign many unequal treaties with various foreign powers, including the U.S. China was essentially partitioned so that she did not even have sovereignty over her own country. China became weaker physically, militarily, and economically. Many of her citizens were addicted to opium brought in and sold by Britain, which generated strong resentment against the foreign powers among the Chinese people. Burlingame, as the U.S. Ambassador to China, not only saw that this kind of foreign policy was immoral and unjust, but had the foresight to realize that, in the long run, this approach





*Anson Burlingame, an American diplomat standing with the 'Chinese Embassy to Foreign Powers'.*



was not in the best interests of the U.S. and the American people. If this continued, sooner or later the Chinese people would rise up and throw out all the foreign powers. Then, the U.S. would be shut off from a huge market for American products and access to China's vast natural resources and cheap labor.

Burlingame began pushing for changes in U.S. foreign policy starting with allowing Chinese citizens to be witnesses in the American courts in China. Taking the cue from the American domestic abolitionist movement of 1860s promoting the "equality of men," he worked with Secretary of State William H. Seward to change the American foreign policy toward China to be based on the "equality of nations." China sensed that Burlingame was a man of integrity and wisdom, with the vision to see what, in the long term, was in the best interests of the U.S. and China. So, China offered Burlingame the job of China's Ambassador to All the Treaty Powers, including the U.S. Realizing that this opportunity could alter the relationship

between the U.S. and China in ways that would benefit both nations, Burlingame set aside his personal goal of running for higher office in the U.S. and accepted the position.

### **Burlingame Treaty of 1868**

It was not an easy task to persuade the U.S. Senate to change a foreign policy of unequal treaties to a foreign policy based on the equality of nations. Using all his oratorical skills and working closely with Secretary of State Seward, Burlingame was successful in persuading the U.S. Senate to ratify what came to be known as the Burlingame Treaty, which President Andrew Johnson signed in 1868. This treaty was based on equality of nations and provided reciprocity on various foreign relationships between the U.S. and China.

Such a treaty would have established a solid foundation for selling American products in China, accessing China's vast natural resources, and utilizing China's cheap labor, and would have resulted in a win-win situation for both



*Taking the cue from the American domestic abolitionist movement of 1860s promoting the “equality of men,” he worked with Secretary of State William H. Seward to change the American foreign policy toward China to be based on the “equality of nations.”*

countries. Unfortunately, Burlingame died in February 1870 while on a mission to Russia. Most of the treaty was never implemented. Furthermore, with President Lincoln assassinated and Reconstruction politics creating turmoil, the Burlingame Treaty was basically repealed in the following decade. In a reactionary period, the U.S. reasserted its imperialistic attitude toward China based on military might, and extremely discriminatory anti-Chinese laws were passed in the U.S., with the most noteworthy being the Chinese Exclusion Act of 1882, which is the only law in American history to deny citizenship or entry based on a specific nationality. This act remained in effect until 1943 when the U.S. and China were allies during World War II.

Mark Twain wrote the following obituary for Burlingame: “In real greatness, ability, grandeur of character, and achievement, Anson Burlingame stood head and shoulders above all the Americans of to-day, save one or two... He was a good man, and a very great

man. America lost a son, and all the world a servant, when he died.”

### **America’s foreign policy toward China since World War II**

Ever since the late 1940s, when it appeared that the Chinese Communists would win the civil war in China, the U.S. has adopted a China policy that is not based on equality of nations but rather a policy to surround, isolate, and weaken China.

The first policy was the decision not to prosecute Emperor Hirohito, even though he was a hands-on emperor who was fully aware of and approved what Japan did during the war.<sup>[1]</sup> If the Emperor of Japan did not do anything wrong, then Japan does not have to apologize for its massive atrocities during WWII, which Japan still has not, even though 71 years have passed since the end of WWII.

After the People’s Republic of China was established in 1949, U.S. did not

*The so-called pivot to Asia by the U.S. is really just a continuation of her long policy to surround, isolate, and weaken China.*

recognize the PRC for 30 years. The U.S. orchestrated the 1951 San Francisco Peace Treaty that was the official treaty ending WWII with Japan. China, the country that suffered the most damage from Japan, was not (neither the PRC nor the Taipei-based Republic of China) invited to attend, although over 50 other countries were invited. This treaty only stated that Japan should relinquish former Chinese territories such as Taiwan, but did not explicitly say that they should be returned to China. This ambiguity could be considered the beginning of a long diplomatic

claim that these islands are covered under the Japan-U.S. Mutual Defense Treaty. In other words, U.S. showed itself willing to go to war with China with no moral or legal justification.

Regarding the South China Sea dispute, American mass media and speeches of American political leaders constantly criticize China for violating international laws as specified under the United Nations Convention on the Law of the Sea (UNCLOS). However, studying the facts about this issue



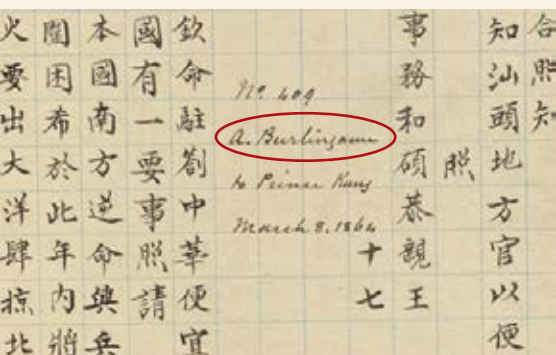
*The Chinese mission led by Anson Burlingame met with the U.S. President Andrew Johnson.*

battle over how the U.S. and China should recognize Taiwan.

On December 25, 1953, the U.S. Civil Administration of the Ryukyu Islands issued, with no legal grounds whatsoever, Civil Administration Proclamation No. 27 and unilaterally included the Diaoyu Islands as part of the Ryukyu Islands, whose administrative rights would be handed over to Japan in 1972. Although on many occasions the U.S. would state that it does not take a position regarding the territorial sovereignty of the Diaoyu Islands, the U.S. would also

will lead to the conclusion that, yes, there is an abuse of power, but the country doing the abuse is the U.S., not China. The U.S. has accused China of military aggression and creating instabilities in the world, but it is the U.S. that has military bases all around China, and has military alliances with Japan, South Korea, the Philippines, Australia, and New Zealand. The U.S.'s huge 7th Fleet is patrolling the waters all around China with 60-70 ships and submarines, 200 to 300 aircrafts, and about 40,000 sailors and marines.

The so-called pivot to Asia by the U.S. is really



Historical documents bearing Anson Burlingame's name in English and Chinese.

just a continuation of her long policy to surround, isolate, and weaken China.

### Is the American foreign policy toward China in the best interests of the U.S. and the American people?

During the 65-plus years of the U.S.'s surround/isolate/weaken foreign policy toward China, China might have been surrounded and often isolated, but today she is definitely not getting weaker nor isolated. Based on the number of countries showing interest in China's "One Belt One Road" initiative to interconnect China and most of Asia and Europe and the related Asian Infrastructure Investment Bank (AIIB), China is growing economically stronger, and more connected with the global economy.

Of course, every country's first priority is for the welfare of their country. I have no quarrel with that. I do, however, wonder if U.S. foreign policy toward China is in the best interests of the U.S. and the American people over the long term.

Allying so closely with Japan could result in irreparable damage to the U.S.' claim as an advocate of justice and human rights, since Japan has never admitted much less apologized for the massive and inhumane atrocities that she inflicted all over Asia during WWII.

Through various mutual-defense treaties, the U.S. is ready to go to war with China over disputes that the U.S. has no legal or moral reasons to be involved. A war with China would be an extremely costly and protracted war, perhaps involving nuclear weapons. There will be no winners in a nuclear war in the 21st century between the world's top two economies.

While competing with China, instead of adopting an uncalled-for antagonistic attitude, the U.S. should work together with China to solve many of the world's critical problems, such as fighting against terrorism, environmental protection, world hunger, and world peace. At the same time, the U.S. can join China and other countries to improve inter-

*Through various mutual-defense treaties, the U.S. is ready to go to war with China over disputes that the U.S. has no legal or moral reasons to be involved.*

country, inter-continent infrastructure, e.g., transportation via high-speed trains. Working together on these projects not only is beneficial to the world, but U.S. companies and workers would also share in the benefits of working on these huge, cutting-edge, and profitable projects, which could lead to vast economic opportunities that these projects might open up.

Instead of adopting a Tonya Harding-like foreign policy to unfairly attack her main competitor, the U.S. should focus its energy to look within herself to improve her country's competitiveness as a whole, which should bring vast economic benefits to the American people.

In the long run, the current U.S. policy to surround, isolate, and weaken China is not in the best interests of the U.S. and the American people. A win-win-win strategy would be more promising: A win for the U.S. and a win for China is a win for world peace.

With the recent change of political leadership in the U.S., it is an opportune time for the Trump administration to take a fresh look at the U.S.'s foreign policy toward China. President Trump's selection as the U.S. Ambassador to China, Iowa governor Terry Branstad, has a long relationship with Chinese President Xi Jinping, which could lead to warmer relationship with China. On the other hand, Trump has always been a severe critic of China. Will he heighten the U.S. policy to surround, isolate, and weaken China, or will he, perhaps after some twists and turns,

realize that the best interests of the U.S. and the American people will be served by a policy that is based on equality of nations. We just have to wait and see.

Like Anson Burlingame's vision, a realistic 21st century U.S. policy toward China must reflect honest history and appreciation of culture, and that different countries with different historical and cultural backgrounds may do things differently. Treating other countries as equals will lead to long-term friendships, cooperation, and win-win for everyone.

Which American leaders will stand up, head and shoulders above the others? The U.S. and the American people, as well as the rest of the world, will benefit from such leadership. Using Mark Twain's words, who will become the next Anson Burlingame, a son of America, and a servant of the world?

[1] Herbert P. Nix, *Hirohito and the Making of Modern Japan*, Gerald Duckworth & Co Ltd; 2001.

*Like Anson Burlingame's vision, a realistic 21st century U.S. policy toward China must reflect honest history and appreciation of culture, and that different countries with different historical and cultural backgrounds may do things differently.*



# “Beautiful Country” but Dispensable?

As the TPP trade pact fizzles away, China would happily expand its domain of influence in the Pacific Rim region while U.S. allies and friends inevitably look for a more reliable partner in the neighborhood. As these geopolitical realities set in, will Trump’s campaign promises to “Make America Great Again” eventually result in “Making China Great Again” and leave the U.S. much less relevant?



**Patrick Mendis**

*Associate-in-Research,  
Harvard University*

The new governing principle in the United States is unpredictability. In not only domestic policies, President Donald Trump’s often changing foreign policy positions and unorthodox diplomatic exchanges have made the traditionally reliable U.S. an unpredictable partner in international affairs, especially in Sino-American relations and Pacific affairs.

Unpredictability may well be the new normal as “the indispensable nation” is appearing to isolate itself from international trade relations. Trump has already made good on his vow to terminate the Trans-Pacific Partnership on his first day in the White House. Unveiling his plans for the first 100 days, however, he was conspicuously silent on his other campaign promise to withdrawing from the North American Free Trade Agreement. Nonetheless, he has been clear about his intention to renegotiate the treaty with Mexico and Canada.

With Trump's effective demolition of the TPP trade pact, China would happily expand its domain of influence in the Pacific Rim region while American allies and friends inevitably look for a more reliable partner in the neighborhood. As these geopolitical realities set in, will his campaign promises to "Make America Great Again" eventually default to "Making China Great Again" and leave the U.S. a dispensable nation?

### Empowering China

The assertive China is taking note that the "declining" America is giving up on its founding trade vision and empowering it with China's commercial mission through the One Belt, One Road (OBOR) strategy. At Peru's 21-member Asian Pacific Forum in last November, President Xi Jinping reaffirmed the summit leaders that China would indeed invite the TPP member-nations to join the Beijing-supported Regional Comprehensive Economic Partnership along with the Association of Southeast Asian Nations.

Acknowledging the kiss of death for TPP under the incoming Trump administration, President Barack Obama warned of the detrimental impact on not only the U.S. economy with a protectionist president in the White House, but also American credibility around the world. Cancelling the colossal 12-nation Pacific Rim trade pact and even renegotiating NAFTA

is no panacea for America's domestic social decay, racial tensions and economic problems, which are largely attributed to technological advancements, demographic changes, corporate strategies and taxation structures.

Despite campaign promises, it is likely that Trump's on-the-job-training may show him that the checks-and-balances in the U.S. government work different from running a private enterprise. The Republican-leaning Wall Street financial companies, American multinational corporations, and the U.S. Chamber of Commerce would certainly challenge his trade and foreign policy positions. In his meeting with Prime Minister Shinzo Abe of Japan, the other leading TPP member, the Trump has already learned about the greater implications for withdrawing from the trade pact.

Nevertheless, President Trump will have greater flexibility in the White House that has traditionally and increasingly been driving American foreign and trade policy. The Trump administration will certainly change course, especially in dealing with China.

### The deal-making president

Once Congress gets involved in White House initiatives, the president may change his mind

*With his unyielding desire for personal trumps, a potential renegotiation and rebranding of TPP into a "Trump-Pacific Power" might be possible with bilateral trade agreements with each of 11 other trade partners.*



*President Donald Trump talks of 'renewal of the American spirit' in the speech to Congress on Capitol Hill in Washington, Feb. 28, 2017.*

once again. With his unyielding desire for personal trumps, a potential renegotiation and rebranding of TPP into a “Trump-Pacific Power” might be possible with bilateral trade agreements with each of 11 other trade partners. He seems to believe that bilaterally negotiated trade pacts will “bring jobs and industry back onto American shores” by using the techniques and insights expounded in his 1987 book, *The Art of the Deal*.

As the self-professed titan of deal-making, Trump could “Make America Great Again,” by simply embracing the founding vision of Thomas Jefferson for political reasons: “Commerce with all nations, alliance with none, should be our motto. Money, not morality, is the principle commerce of civilized nations. Peace, commerce and honest friendship with all nations; entangling alliances with none.” Acting more like a Jeffersonian Republican, he may trade with everybody, like the Chinese do. After all, Trump has also said, “I love China and the Chinese people.”

His other incendiary rhetoric during the presidential campaign, however, included accusing Beijing of “raping” the U.S. with its trade policies. When he realizes the mutually beneficial trade relationship between China and the U.S. is more complicated than his contradictory comments, Trump will have no choice but to strengthen the evolving Sino-American bond without losing out to the Chinese leadership and its rule-making power in global trade architecture.

In Trump’s mind, the TPP trade deal was “a potential disaster” for the United States. This was not the case for former U.S. Secretary of Defense Ash Carter, who insisted, “Passing TPP is as important to me as another aircraft carrier” to maintain geopolitical supremacy. To advance his putting “America First” agenda in “producing steel, building cars, or curing disease” in “our great homeland,” President Trump must depend on the global supply chain. When the Trump White House begins to deal with other countries, the elephant at the table of every trade negotiation will be

*Trump is a pragmatist and a dealmaker, whose objective is winning.*

China, whose bilateral relations expanded into over 140 countries.

### Undoing strategic mistakes

Ignoring China is a mistake. The Sino-American relationship has been mutually beneficial for both countries. The golden era began long before the republic was born in colonial America but it became official with the sailing of the Empress of China from New York to Canton (Guangzhou) in 1794. The Opium Wars and the Taiping Rebellion in China and the American Civil War changed the course of that trade history even though the Chinese immigrants contributed to the building of American railroad civilization in the late nineteenth century.

Yet after all calamities and tragedies in ensuing years and two World Wars and the Vietnam War, Deng Xiaoping returned China to its once-held tradition of trade, investment, and opening-up policy after the death of Chairman Mao Zedong. Later President Bill Clinton's White House supported China's membership in the World Trade Organization, after which the two nations fundamentally intertwined in not only trade and economic relations, but also the people-to-people exchange expanded exponentially. Today, more than a quarter-million Chinese students, for instance, spend billions of dollars in American universities and small business ventures thrive on China trade from Indiana to Virginia.

Trump's proposed 45 percent tariffs and other economic sanctions against America's banker in Beijing is counterproductive and possibly treacherous. As of September 2016, the U.S. owes China over \$1.15 trillion—30 percent of the American Treasury securities. Republican Congressman Randy Forbes correctly calculated that “Each day our nation pays

communist China \$73.9 million in interest on our debt.” And yet the president thinks that the United States has “tremendous power” over China because the world's second-largest economy depends on American prosperity.

Given his business acumen as a dealmaker, the Trump presidency is generally viewed as better for China (as opposed to a Hillary Clinton White House) despite his China-bashing one day and China-loving rhetoric the next. Former CIA director James Woolsey under President Clinton, now a top adviser to President-elect Trump, criticized the Obama

*The Trump White House may use these leaders tactically through bilateral engagements to hedge against China.*

administration for its decision to not join the Beijing-led Asian Infrastructure Investment Bank that was created to provide funds for President Xi's One Belt One Road initiative. Ignoring the Obama White House, US allies such as the United Kingdom, Germany, France, Italy and even India signed up with the Beijing bank.

With Wall Street billionaires and millionaires in the cabinet and the growing pressure from his 16-member Wall Street “kitchen cabinet” (also known as the Strategic and Policy Forum) led by Sino-American financier Stephen Schwarzman, the Trump White House could consider joining AIIB. Trump is a pragmatist and a dealmaker, whose objective is winning.



Thus, investment opportunities in gigantic OBOR projects are a bonanza for his circles of friends and financiers, including Schwartzman, who endowed the \$100 million Schwartzman College at Tsinghua University in Beijing, modeled after the Rhode Scholarship at Oxford University “to promote [mutual] understanding between China and the rest of the world.”

### Using new leverages

Having financial interests, President-elect Trump has already signaled that he may use a range of alternative leverages to win over the Pacific Rim nations who would otherwise gravitate to China. In addition to meeting with the Japanese prime minister and speaking with President Xi in Beijing, he has made time for strategic if unorthodox phone conversations with leaders of Australia, the Philippines, Pakistan, and a controversial chat with Taiwan’s Tsai Ing-wen.

The Trump White House may use these leaders tactically through bilateral engagements to hedge against China. For some conservative Republicans, the Obama foreign policy towards China—and its assertive behavior in the East and South China Seas, the Korean peninsula, and the cross-Straits relations with Taiwan — was an utter failure like the policies in Afghanistan, Libya, Syria and elsewhere. Unlike Obama’s multilateral approach to these conflicts, the Trump administration may choose a bilateral approach, just like China does in the South China Sea over territorial sovereignty with the Philippines and Vietnam within the nine-dash line.

While signaling these leverage points, the Trump White House is likely to accelerate the

on-going U.S.-China Bilateral Investment Treaty simultaneously. With all these unconventional diplomatic maneuverings in progress, the Trump strategy would also force Beijing to give up the support for inefficient state-owned enterprises that the Obama administration failed to address as China celebrated the 15th anniversary of WTO membership in December. Thus, the gaining the “Market Economy Status” of WTO is controversial, especially when SOEs are still in place, but China enjoys the benefit of global commerce and world recognition as a reliable trading partner.

Given all this, the Trump presidency can hardly “Make America Great Again” without making “China Great Again.” Just as President Xi’s One Belt One Road initiative is designed to revive the Chinese nation and Confucian culture, which were once admired by American Founding Fathers as models for the new republic and the U.S. civilization, Trump may want to revisit Sino-American history before facing off with the increasingly assertive China.

The evolving multifaceted bilateral relationship is intrinsically complicated yet mutual prosperity for the U.S. and China is connected largely through trade, investment, and people-to-people exchange. No matter what prospects the Trump White House may have for China and the world, one thing is predictable: The U.S. will and must accept China’s inevitable rise. Under President Trump, will that eventuality make the “Indispensable Nation” a dispensable but “Beautiful Country” (美国) as the Chinese call America?

*Given all this, the Trump presidency can hardly “Make America Great Again” without making “China Great Again.”*

# Shaping Trump's Outlook Toward China



The Asia Society and the University of California, San Diego, under the co-chairmanship of Orville Schell and Susan Shirk, have published a task force report on “US Policy Toward China: Recommendations for a New Administration.” Roughly two years in the making, the point of this report in light of the timing — published in February 2017 — is to serve as a guide for the Trump administration.



**George Koo**

*Board Member,  
New America Media*

The Asia Society and University of California, San Diego, under the co-chairmanship of Orville Schell and Susan Shirk, published a task force report on “US Policy Toward China: Recommendations for a New Administration.” Schell is head of the Center on US-China Relations at Asia Society and Shirk is head of School of Global Policy and Strategy at UCSD.

Roughly two years in the making, the point of this report in light of the timing — published in February 2017 — is to serve as a guide for the Trump administration. Near the beginning of the Executive Summary is the statement that reads: “It is in the national interest of the United States to strive, if possible, for stable and mutually beneficial relations with China, and to maintain an active presence in the Asia-Pacific region.”

As they read this report, the China-bashing hawks within the administration won't necessarily see any need to strive for “mutually beneficial relations with China.” Moderates in and out of the White House, on the other hand, may find the generally unfriendly (toward China) tone of the report surprising.

Aside from the two co-chairs, there are 12 members identified as “task force” co-authors. Many in this group are known not to hold warm and fuzzy feelings for China, at least not for the Beijing regime. This is clearly in contrast with the six task-force participants that declined to sign on as co-authors of the report. The group of six non-signatories is, in my opinion, among the faction of more empathetic China observers.

The Task Force Report identified six priority issues that the Trump

Administration must deal with immediately while other issues can wait. Since I have just published my recommendation that President Trump has no choice but to collaborate with China, I would like to review the six issues in line with my published views.

### **Work with China to halt North Korea's nuclear and missile program.**

Dr. William Perry, former US Secretary of Defense, recounted in his memoir that by the end of the Clinton administration, the U.S. under his leadership was on the verge of reaching an agreement with North Korea. The provisions would have included Pyongyang agreeing to stop its nuclear program before getting the bomb.

Then the incoming Bush administration elected to ignore North Korea for two years, and when contact resumed, the White House added new demands on Pyongyang. By then, Pyongyang had enough time to complete development to test nuclear weapons and thus became a bona fide member of the nuclear club. Once becoming an owner of “the bomb,” negotiations between the U.S. and North Korea became even more difficult.

Trying to be helpful, Beijing organized six-party talks to see if additional participants, namely China, Japan, Russia, and South Korea, could help break the deadlock. The six-party talks did not, but Washington can now conveniently blame China as the owner of the nuclear North Korea problem. Actually, as I have pointed out in an earlier article, so long as China sits across the table from the U.S. and South Korea, China's hands are tied – the interests of the three states are not

*Someday, the Trump Administration may conclude that the benefits of “reaffirmation” (another word for Obama’s American exceptionalism) cannot justify the cost.*

aligned. China needs North Korea as a buffer state and could not justify applying excessive pressure. Putting the survival of the Pyongyang regime in jeopardy would be against China's national interest.

Recently, before her impeachment, South Korea's President Park had agreed to allow the U.S. to install Terminal High Altitude Area Defense (THAAD) inside South Korea. Since the THAAD missile-defense system is effective against long range, high trajectory missiles, installing the system in South Korea would allow missiles heading for Seattle or Los Angeles to be intercepted, but wouldn't do much to protect Seoul across the border from low-trajectory, short-range missiles. Park's muddle-headed decision put her relations with Beijing in the deep freeze, and of course has not encouraged Beijing to want to work with the U.S.-South Korea coalition.

### **Reaffirm U.S. commitments to Asia.**

By “commitment to Asia” the authors mean for the U.S. to continue the role as the world's hegemon. Someday, the Trump Administration may conclude that the benefits of “reaffirmation”

*The feeling of American companies is likely in part due to missing the incentive packages of the “good ol’ days” but certainly provides grounds for negotiation.*



*The Asia Society and the University of California, San Diego, under the co-chairmanship of Orville Schell and Susan Shirk, held a press conference for the launch of “US Policy Toward China: Recommendations for a New Administration.”*

(another word for Obama’s American exceptionalism) cannot justify the cost.

### **Deploy effective tools to address the lack of reciprocity in U.S. trade and investment relations with China.**

“The benefits to the US economy from US-China trade and investment are substantial, but rising protectionism in China and job losses in the United States—some of which are attributable to trade with China—are undermining public support for the broader relationship.” In the early days of the bilateral relationship, China provided all sorts of incentives and tax breaks to entice American companies to invest in China. Now that China has become an economic peer relative to developing countries, they are taking away the incentives. I suspect some of the feeling of “lack of reciprocity” is caused by foreign companies having to compete with local companies, now without the benefit of subsidies.

The feeling of American companies is likely in part due to missing the incentive packages of the “good ol’ days” but certainly provides grounds for negotiation. The American Chamber

and the National Business Council are quite capable of taking the lead in discussing fairness of American companies in China. We all know everything in China is negotiable.

There is no direct linkage between trade with China and loss of jobs in the U.S. The Trump Administration should instead focus on how to generate a continuing supply of qualified workers that would meet the needs of plants in the U.S. driven by high technology such as automation and artificial intelligence. Chinese companies are also looking for skilled workers in the plants that they wish to locate in the U.S. That’s where the employment gap is at and that’s where new jobs will be created.

### **Intensify efforts to encourage a principled, rules-based approach to the management and settlement of Asia-Pacific maritime disputes.**

Ironically, the U.S. has been the greatest cause of tension in the South China and East China Seas. To calm the waters, the Trump Administration should remove the irritant of constant surveillance by American naval ships and planes off China’s coast. Malaysia, Philippines and

*To calm the waters, the Trump Administration should remove the irritant of constant surveillance by American naval ships and planes off China’s coast.*



*Judging from the flow of negative portrayal of everything related to China that dominates the American media, China has been doing a terrible job, and this matter should be the least of Trump's worries.*

Vietnam have all shown that they are capable of settling their disputes with China amicably without Uncle Sam in the room.

As for the East China dispute, it's time the White House recognizes that the U.S. deliberately sown the seeds of discord when Washington handed administrative control of Senkaku (Diaoyu in Chinese) to Tokyo in 1971. Until that point, there was no basis that those East China islands belong to anyone else other than Beijing or Taipei. If there was to be a dispute, it should have been between the two parts of China.

**Respond to Chinese civil society policies that harm U.S. organizations, companies, individuals, and the broader relationship.**

Bill Gates famously said when operating in another country, you would expect to abide by the rules and regulations of that country. It certainly would be the height of arrogance to expect every country to abide by American rules because America is exceptional. That said, I do believe unfettered exchange between the people of the two countries would greatly benefit both countries—so long, of course, as the exchanges take place without hidden malice and pernicious intentions. Exchanges should promote mutual understanding and trust while culturally enriching each other.

The report further claims that the current situation “allows China to exert an inequitable influence over U.S. public opinion through an unfettered flow of its propaganda.” The Trump Administration should continue to

allow, nay encourage, the Chinese to exert its influence. Judging from the flow of negative portrayal of everything related to China that dominates the American media, China has been doing a terrible job, and this matter should be the least of Trump's worries.

**Sustain and broaden U.S.-China collaboration on global climate change.**

This is an excellent recommendation. The world's perception is that China has already assumed the leadership on dealing with climate change. For the U.S. to regain its place, certain members of the Trump Administration need to first take a tutorial on basic scientific truths. They need to accept that the world is not 6,000 years old and evolution as posited by Darwin is not some Marxist-Leninist propaganda. Then they should think about the kind of legacy they want to leave for the future generations.





Physically, THAAD serves as an Iron Curtain to intercept incoming missiles from North Korea. Separate national security interests have supplanted Cold War ideology, but THAAD could influence competing alliances and block cooperation among the countries involved in the “Six Party Talks.”



**Fan Gaoyue**

*Former Chief Specialist,  
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## Iron Curtain Rises with THAAD

North Korea launched four ballistic missiles to protest ongoing U.S.-South Korean military exercises on March 6. The next day two U.S. THAAD launchers arrived in South Korea, despite China's stern warning that South Korea and the U.S. should bear all the consequences caused by the deployment of THAAD. South Korea's acting president Hwang Kyo-ahn noted that Seoul should swiftly complete the deployment of THAAD system, and it was reported that THAAD could be in place as early as April. With THAAD in South Korea, the Iron Curtain of a new Cold War rises.

The term of “Iron Curtain”, originating in the early 19th century and originally referring to fireproof curtains in theaters, became popular after Winston Churchill used it in a speech at Fulton, in the U.S. state of Missouri, on March 5, 1946. In the Cold War, the Iron Curtain was the name for the boundary dividing Europe into two separate areas, with Warsaw Pact countries on the east side and NATO countries on the west side.

*The difference between the old and new Cold War is that the old one was based on ideology and the new one is based on national security interests.*

Once THAAD is deployed in South Korea, it will serve as an Iron Curtain to divide the Korean Peninsula into two areas: on the south side of the 38th parallel are the countries that support the deployment of THAAD, including South Korea, Japan and the U.S.; on the north side of the line are the countries that oppose the deployment of THAAD, including North Korea, China and Russia. Although the countries on the north side of the 38th parallel are not military allies, they might be driven to cooperate with each other by the common threat of THAAD. Thus a new Cold War between the south and north side of the line will gradually come into being. The difference between the old and new Cold War is that the old one was based on ideology and the new one is based on national security interests.

Physically, THAAD serves as an Iron Curtain to intercept incoming missiles from the north side. Metaphorically, THAAD serves as an Iron Curtain to block cooperation among the “Six Party Talks” countries. The reasons are as follows.

#### **THAAD in South Korea will cause chain reactions.**

The deployment of THAAD in South Korea might stimulate the deployment of THAAD at Aomori Prefecture, Kyoto Prefecture, and Okinawa in Japan, as well as Manila in the Philippines and potentially other places. This, combined with *Patriot* and *Aegis* missile defense systems deployed in the region would constitute an integrated missile defense

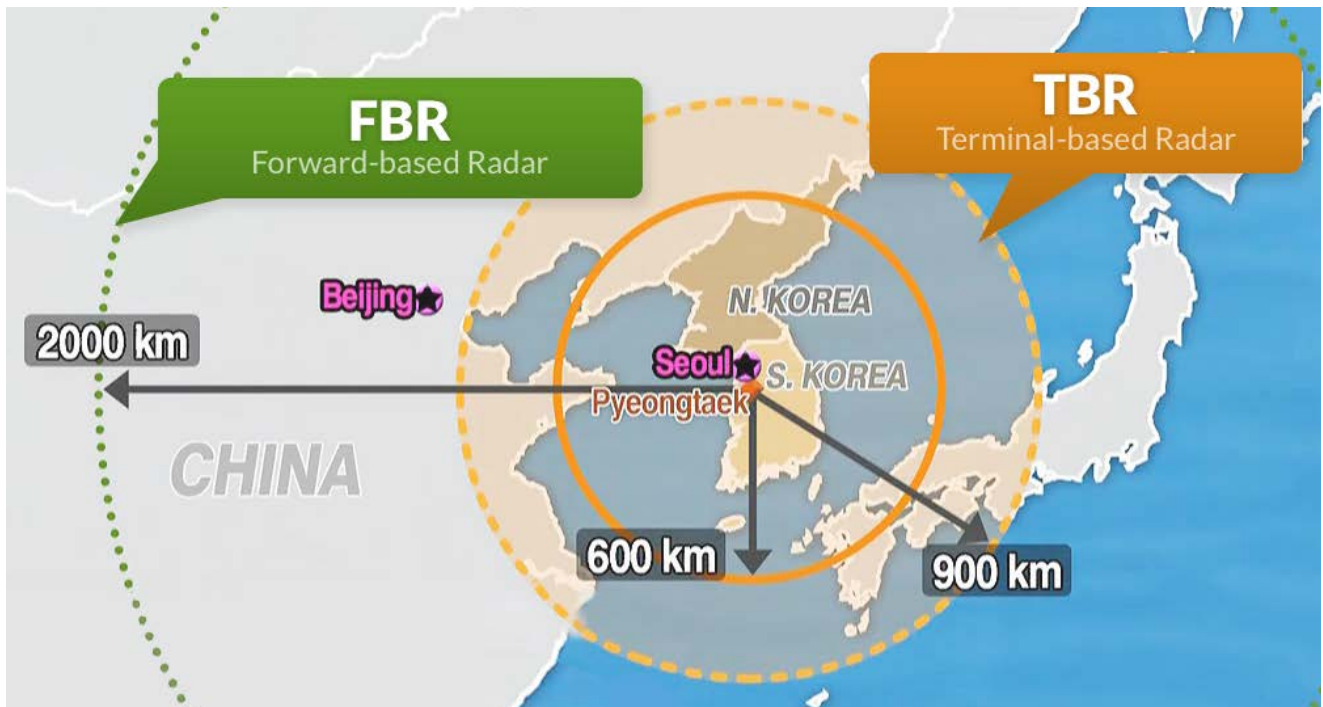
system of low, medium, and high altitude defense capabilities. Such a missile defense system forms an enormous missile defense arc, which greatly impairs the strategic deterrence capabilities of China and Russia.

#### **THAAD in South Korea will serve as a belt to tether South Korea onto the U.S. war chariot.**

The U.S. has failed to transform bilateral military alliances into regional multilateral alliances because of deep historical animosity between South Korea and Japan. With the deployment of THAAD, South Korea will have to cooperate with Japan militarily whether it is willing or not, thus creating necessary conditions for the U.S. to build an Asian version of NATO.

#### **THAAD in South Korea will make the North Korean nuclear issue even more difficult to solve.**

China and Russia have recently cooperated very well with the UN and all the other parties concerned in dealing with the North Korean nuclear issue. With THAAD in South Korea, China and Russia would feel that South Korea and the U.S. have defied their national security concern and interests, and may become less cooperative in solving with North Korean nuclear issue and the other international affairs.



A THAAD battery consists of nine launcher vehicles, each equipped with eight missiles, with two mobile tactical operations centers and an X-Band radar. A THAAD missile has an operational range of 30-200 km and an altitude range of 15-150 km. Its X-Band radar (AN/TPY-2) can detect and track a conventional ballistic missile within 4000km and a signal-reduced ballistic missile within 2000km.

### **THAAD in South Korea will give rise to an arms race and a new Cold War.**

According to contemporary strategies of nuclear deterrence, China and Russia will have to deploy forces and weapons into areas close to the Korean Peninsula to balance the potentially adverse influence of THAAD capabilities. To respond to China and Russia's actions, South Korea and the U.S. would then be called to further increase their own military capabilities, thus contributing to an arms race

in the Korean Peninsula. NATO's eastward expansion has already made Russia more hostile toward the West. The deployment of THAAD has made China hostile toward South Korea and the U.S. What's more, it might compel China and Russia form an alliance to deal with what could be seen as a common threat.

History tells us that only one small incident can change global strategic patterns if not prudently handled. The murder of Archduke Franz Ferdinand

*With the deployment of THAAD, South Korea will have to cooperate with Japan militarily whether it is willing or not, thus creating necessary conditions for the US to build an Asian edition of NATO.*





Trucks carrying parts of U.S. missile launchers and other equipment needed to set up the controversial missile defense system - Terminal High Altitude Area Defense (THAAD) arrive at the Osan Air Base, South Korea on March 7. (Photo: U.S. Forces Korea)

of Austria touched off the First World War and the intelligence that Iraq possessed chemical weapons triggered the Iraq War. What might the murder of Kim Jong-nam and the deployment of THAAD trigger? Whether the result is a hot war or a cold war, it is not what we would like to see because it goes against the 21st century trend of peace, development, cooperation and win-win diplomacy. Therefore I sincerely hope that South Korea and the U.S. could value the hard-earned strategic trust developed over the last decades, and seriously consider the potential risks the

deployment of THAAD pose toward peace, stability, cooperation, and development in Northeast Asia. I also would like to recommend that the U.S. stop the deployment of THAAD immediately, or pull the THAAD battery out of South Korea when its Foal Eagle 2017 exercises come to an end on April 30.

*What's more, it might compel China and Russia form an alliance to deal with what could be seen as a common threat.*

# THAAD: U.S. Assets, Lotte Liabilities?

The recent Lotte crisis is a recurring incident in East Asia's power dynamic: one country wields economic weapons to score geopolitical goals against another. In a region where China and U.S. lack strategic trust and security cooperation, everyone stands to lose when economics and geopolitics get tangled.

Keeping the two in separate dimensions and preventing risks from one realm spilling over into the other are imperative.



**Xu Duo**  
*Fox Fellow,  
Yale University*



Japan's online shopping company Rakuten issued a statement on February 28, begging Chinese consumers not to confuse its brand name with Lotte, a South Korean company mired in the depths of a diplomatic row with China (the two names are spelled in exactly the same Chinese characters).

Some people may find this statement hilarious and the Japanese over-jittery, yet it is far from a laughing matter. China lashed out at South Korea's Lotte Group after the company's board approved a land-swap deal with the South Korean government. The land in question will be used to deploy a U.S. missile defense system, with radar believed to be capable of penetrating Chinese territory.

China's state media said in commentaries that the Chinese consumers have every right to say no to companies like Lotte, which pander to government pressure in the name of "national security" at the price of other countries' interests. The Chinese people, the commentaries went on, would not condone those foreign businesses that reap huge profits in China while trampling on Chinese people's feelings. Put into this context, Rakuten's seemingly overreaction is understandable and makes perfect business sense.

Economics and geopolitics are two most important realms where countries interact. Oftentimes they align with each other. Robust economic relations boost trust and cooperation in security alignments,

*In the absence of an Asia-wide security arrangement incorporating all key players in the region, keeping economics and geopolitics in separate dimensions is probably the best we can get for right now.*

and vice versa. Trans-Atlantic ties between the United States and its NATO allies in Europe fall into this category (or at least it was so in the pre-Trump era). Intertwined economic exchange across the Atlantic strengthens security bonding, and a consolidated security alliance further promotes closer economic activities.

Whereas these two realms positively reinforce each other in the Atlantic, they seem to be correlate negatively in East Asia. Too often we see the weird scenario of “hot economy versus cold politics” between China and Japan. In the absence of an Asia-wide security arrangement incorporating all key players in the region, keeping economics and geopolitics in separate dimensions is probably the best we can get for right now.

However, the Lotte incident demonstrates China’s latest attempt to employ economic means to achieve geopolitical ends. Though the state stopped short of an explicit call for an outright boycott of Lotte products, punitive actions, even if covert ones, might follow. From China’s perspective, its gigantic economic weight is powerful enough to subjugate its unwilling neighbor.

The response on China’s side comes as no surprise to readers even moderately familiar with East Asian news. This is a recurring incident and part of a broader pattern that gets replayed in the power dynamic between regional nations. Yet such a reaction is by no means a judicious one, even if we take into consideration China’s interests alone.

To start with, using economic means for geopolitical ends rarely achieves projected goals. Economic cards hold little leverage over security issues in that security concerns override everything else as they speak directly to a nation’s survival instinct. More often than not, playing economic cards not only fails to secure geopolitical wins, but also hurts one’s own economic positions.

The 2012 anti-Japanese protests in China offer a perfect example here. After the Japanese

*Moreover, brandishing economic weapons is likely to invite similar countermeasures from other countries.*

government announced it would buy part of the Diaoyu/Senkaku islands to stall a similar move offered by the Tokyo government, protests and demonstrations against Japan swept across major cities in China. The protests deteriorated into violent actions targeting Japanese companies, with angry people damaging, looting and destroying shops, cars or anything they associated with Japan. Furthermore, Chinese authorities ordered travel agencies to suspend Japan tours.

Ironically, fickle consumers are so forgetful that they switch loyalty in no time. The very people who were protesting against Japanese products (most of them are actually made in



Chinese factories by Chinese workers) in 2012 became the backbone of a shopping spree in Japan several years later. Millions of Chinese tourists bought their way into major Japanese cities, purchasing everything “Made in Japan”, from toilet seat covers to rice cookers, from OTC medicine to baby formula.

And the result? Diaoyu/Senkaku islands remain under Japan’s administrative control, and the mutual animosity further deepens between Chinese

and Japanese people. On top of that, a more disturbing trend has set in. Ever since the 2012 protests, Japanese businesses have started diverting investment from China to Southeastern Asian countries. In 2015, foreign direct investment from Japan to the 10-member ASEAN exceeded that to China and Hong Kong

for the third consecutive year. And the pace has been accelerating. Within a five-year span by 2015, investment to ASEAN almost tripled. On the other hand, Japanese investment to China dropped over 25 percent in 2015, also for the third straight year. Though other factors like greater growth potential and lower labor costs in ASEAN countries contribute to this trend as well, volatile relations between China and Japan have apparently weighed heavily on businessmen’s calculus and damped their long-term enthusiasm for China.

Moreover, brandishing economic weapons is likely to invite similar countermeasures from other countries. In 2014, China set up an oil rig in the disputed areas of South China Sea, triggering widespread anti-Chinese protests in Vietnam. Protesters damaged and destroyed hundreds of factories, incurring losses in millions of dollars.

In addition, punishing foreign businesses and establishing trade barriers run counter to

international trade rules. In retaliation for Japan’s detention of a Chinese trawler captain near Diaoyu/Senkaku in 2010, China banned rare earths exports to Japan. The United States, backed by Japan and EU, filed a lawsuit with WTO in 2012, which ruled against China in 2014 and made it drop the export quotas in 2015. Such actions tarnish China’s image as a reliable business partner, an investment-friendly market, and a responsible global

player, and is prone to provoking trade disputes and retaliatory measures.

From South Korea’s perspective, Lotte is obviously the one taking the hardest hit. Unlike Japanese counterparts who have long been hedging against political volatilities ever since the Diaoyu/Senkaku incident, South Korean businesses have huge exposures to Chinese markets. Caught off guard by the THAAD issue as it first emerged last year, Lotte Mart in China reported over \$88 million in operating losses in 2016 alone and is said to be closing three



*Protesters hold posters during an anti-THAAD rally in front of the Lotte department store in Seoul, South Korea on Feb. 23, 2017.*



*For China, it should understand that economic leverage would never be translated into geopolitical victory automatically.*

retail stores near Beijing soon. South Korea, the country as a whole, might fall victim as well. China is South Korea's top exporting destination in 2015, with exports valued at almost double those of the United States (South Korea's second largest exporting market), and over five times those of Japan. China is also South Korea's largest importing origin, with values double those of Japan, the country's second-largest importing country. Should any Chinese punitive action materialize, South Korea, a foreign trade-driven economy, is expected to sustain enormous losses.

Even the United States, a seemingly supporting player in this bilateral act, stands to lose. It is simply not in America's own interests to see its regional ally hurt economically and humiliated diplomatically. If such a pattern repeats itself in the future, America's allies would have to make the hard choice of picking sides between the U.S. and China, a scenario Washington would rather not see. More significantly, angering China affects in a direct way America's long-term security prospects in the region. Deploying THAAD was meant to deter a North Korea running amok, but if this very move antagonizes China, America's most influential partner in containing Pyongyang, it would hurt, rather than help, Washington in achieving its strategic goals. After all, China is not Iran or Russia, with which America shares no significant economic ties, and thus sanctions against those regimes

are effective enough to bring them to their feet. Both the United States and its regional allies enjoy profound economic interactions with Beijing. Souring this relationship cuts both ways, and cuts deeply.

Then how to cope with this situation? For China, it should understand that economic leverage would never be translated into geopolitical victory automatically. If used unwisely, it accomplishes nothing but makes things worse. It is imperative for the government to prevent geopolitical risks from spilling over into economic realms, and refrain from punishing foreign business community, the only bright spot in Sino-Korean and Sino-Japanese relations, for something not of its own making.

For South Korea and the United States, they should put forward concrete measures, not just lip service, to assure Beijing that THAAD is not meant to target China. The United States, in particular, needs to think beyond its traditional "hub and spokes" security framework, and try to bring on board China in future security considerations. Even if the two great powers share little in common values, combatting common threats posed by a berserk North Korea in and of itself constitutes a good enough reason for cooperation.

*The United States, in particular, needs to think beyond its traditional "hub and spokes" security framework, and try to bring on board China in future security considerations.*

# Trump's Bargaining Chips

Since his days on the campaign trail, Trump has been a huge critic of China. However, he will need to come to terms with the fact that criticizing and alienating China, especially over the threat that North Korea poses, is not wise. North Korea will serve as a test of not just Trump's ability to make a deal but also his ability to employ diplomacy with a rival to address a common and growing threat.



North Korea on March 6 fired four ballistic missiles that flew about 1,000 kilometers (620 miles), with three of them landing in waters that Japan claims as its exclusive economic zone, according to South Korean and Japanese officials.

When an individual is elected President of the United States, that person knows full well that they will face or pursue policies and issues which could ultimately define their presidency for better or for worse. For George W. Bush it was the war in Iraq. For Barack Obama it was Obamacare. For Donald Trump, escalating tensions with North Korea and their expanding nuclear program could

prove to be his defining moment.

After decades of failed attempts to get North Korea to halt the development of its nuclear weapons program, there aren't many options to choose from for Trump and his administration. They include: Increasing sanctions, pushing China to rein in North Korea, launching military action, and finally and arguably most



### **Sampson Oppedisano**

*Legislative Coordinator  
to New York State  
Assemblywoman Galef*

controversial, meeting with Kim Jong-un himself. For the sake of argument, two of these options are already not viable. Increasing sanctions has proved to be ineffective, and military action could result in cataclysm for the region. This leaves Trump with pushing China to play a more active role, or meeting with Kim Jong-un himself.

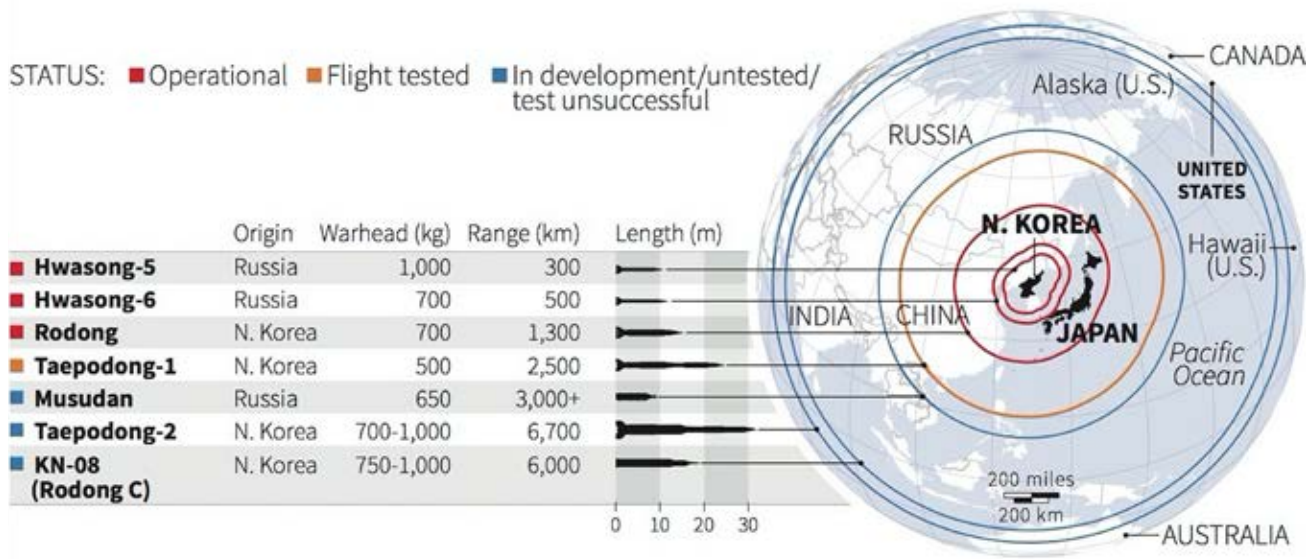
Regardless of which he chooses, confronting Pyongyang will first necessitate Trump to demonstrate two key qualities. First, it will force the real estate mogul turned president to showcase his deal-making abilities that he so regularly touted on the campaign trail last year. Since he has taken office, the public has seen little to suggest that Trump has been hard at work wheeling and dealing his way toward making America great again. Making substantial progress on ending North Korea's nuclear program would not only prove his negotiating skills, but also add much needed legitimacy to his administration, which continues to drop in public approval polls, by accomplishing something none

of his predecessors were able to.

Second, it will force him to engage more with China, which is where the key to success lies. Being North Korea's largest economic partner and ally in the region, China holds influence over Pyongyang, though it has been waning in recent years. Regardless of how Trump decides to act, including China in his plans will be imperative. That said, Trump should not expect China's help to come for free. While neutralizing North Korea's nuclear program is a shared goal between the U.S. and China, both nations still have a plethora of conflicting interests in the region. To include China, and ultimately increase any chances of making progress on North Korea, could require Trump to pull back on U.S. interests in the region to appease China.

Despite being slapped with crippling international sanctions, and being effectively cut off from the developed world, the Hermit Kingdom continues to forge forward with testing and expanding its nuclear capabilities. To

*To include China, and ultimately increase any chances of making progress on North Korea, could require Trump to pull back on U.S. interests in the region to appease China.*



*A comparison of the range and capabilities of North Korea's ballistic missiles.*

offset this threat, the U.S. continues to offer security assurances to its regional ally South Korea through annual joint military drills, as well as the coming deployment of a THAAD missile defense system. While China has acknowledged that it understands South Korea's need to prepare and defend itself from a possible attack by the North, they firmly disapprove of the defense system. This is due to fear that the system's radar would be able to penetrate into Chinese territory. While the United States is unlikely to allow its security assurances to South Korea to be used as a bargaining chip, it is hypothetically possible, especially with Trump's unpredictability and wild-card like decisions. If China respectfully disapproves of such a defense system, then it's safe to assume that the North Koreans vehemently disapprove of it. That said, North Korea could encourage its only ally to persuade

the United States to pull back or halt its assurances with South Korea as a pre-requisite to opening up a serious dialogue. This would allow China to not only help pave the way for possible progress with North Korea, but also potentially prevent, or at least delay the deployment of the THAAD defense system.

Another assurance potentially at stake involves Japan. North Korea's most recent test on February 12 of an intermediate-range ballistic missile drew a joint statement condemning the move from President Trump and Japan's Prime Minister Shinzo Abe, with Trump assuring Japan that it has the full support of the United States. However, China could choose to test how far the United States is willing to go for its historic ally by bringing the Senkaku/Diaoyu Islands into the fray.



*North Korea will serve as a test of not just Trump's ability to make a deal but also his ability to employ diplomacy with a rival to address a common and growing threat.*

While both Japan and China claim ownership over these few islands in the East China Sea, China has begun construction of artificial islands in the region to further assert its claim. In response, the United States has often flexed its military might in the region by deploying fighter jets and nuclear capable submarines in the disputed region to remind China it is always watching and still the regional hegemon.

China could refuse to help the United States in certain capacities such as encouraging its unruly neighbor to participate in discussions, or it could refuse to further supporting and implementing sanctions against the regime. A plausible point of negotiation would be diminished U.S. presence, as China has previously voiced its opinion that the United States needs to stay out of the disputed region. If Trump decides to make it a mission of his administration to find a way to dismantle North Korea's nuclear program, a guarantee that the United States will stay out of the disputed region would be high on China's list of assurances.

Since his days on the campaign trail Trump has been a huge critic of China. However, he will need to come to

terms with the fact that criticizing and alienating China, especially over the threat that North Korea poses, is not wise. North Korea will serve as a test of not just Trump's ability to make a deal but also his ability to employ diplomacy with a rival to address a common and growing threat.



# Is the U.S. Ceding Innovation Leadership to China?

By the early 2020s, rivalry for innovation will accelerate between the U.S. and China. Ironically, the Trump White House has opted for a poor-economy industrial policy, whereas China has embraced a rich-economy policy.

According to the Trump administration, after the 2008 recession, American workers and businesses have suffered the loss of some 300,000 manufacturing jobs and the slowest economic recovery since World War II. Consequently, one of President Trump's key issues is "bringing back jobs and growth."<sup>[1]</sup>

To get the economy back on track, the White House plan is to create 25 million new American jobs in the next decade to restore 4

percent annual economic growth. In contrast, China's recently introduced Five-Year Plan is predicated on rapid progress in advanced manufacturing and innovation capacity.

Curiously enough, the U.S. focus is on the kind of industrial policy that usually typifies less developed economies, whereas China is engaged in innovation strategy, which usually predominates in relatively wealthier economies. What will be the outcome?



*In 1930, the U.S. Congress passed the notorious Smoot-Hawley Tariff Act, which sharply raised the cost of foreign imports. While it seemed to work initially, it soon caused other nations to retaliate.*



**Dan Steinbock**  
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### **Trump's medium-term industrial objectives**

The Trump administration is not the first one to seek the revival of U.S. manufacturing exports. “We will double our exports over the next five years, an increase that will support 2 million jobs in America,” President Obama said in his first State of the Union speech in 2010. While Obama’s National Export Initiative increased concern for protectionism and trade friction among America’s big trading partners, it gradually faded away, along with other Obama legacies.

Today, world exports amount to almost \$18 trillion annually. Almost half of the total can be attributed to only eight export giants, including the European Union (\$2.3 trillion), China (\$2.0 trillion), the U.S. (\$1.5 trillion) and Japan (\$0.6 trillion), followed by South Korea, Hong Kong, Netherlands, and Italy.

In order to raise U.S. export strength by a magnitude, Trump chose Harvard-trained economist Peter Navarro to head the newly-created National Trade Council in the White House. Now Navarro’s job is to oversee industrial policy,

while targeting the trade deficit is expected to pave the way to Trump’s “America First” trade protectionism.[2]

Navarro is a Republican insider who advised President George W. Bush and Mitt Romney’s failed campaign. Navarro and former Nucor CEO Dan DiMicco, another Trump trade adviser, represent not just trade protectionism but an effort to mainstream anti-China bias in America.[3] In this effort, a key executor of Trump’s mandate is billionaire Wilbur Ross, a bankruptcy expert who made his fortune from bankrupt U.S. companies and offshored jobs. He is now Secretary of Commerce.

Until recently, the new industrial policy has been initiated in relatively small scale with relatively narrow impact. If it is adopted on a broader basis, the impact could be substantial and unleash – not so much higher but slower growth, due to fewer productivity gains, but rising inflation, retaliation from trading partners and lower equity prices. There is a historical precedent. In 1930, the U.S. Congress passed the notorious Smoot-Hawley Tariff Act, which

sharply raised the cost of foreign imports. While it seemed to work initially, it soon caused other nations to retaliate.[4]

### China's medium-term industrial and innovation policies

As advanced economies remain mired in stagnation while avoiding necessary changes, China is moving to broader implementation of structural reforms and toward new industries fueled by innovation-driven development.

As evidenced by the recent Two Sessions summits in Beijing, the new five-year blueprint [5] incorporates many recent technology-related initiatives, including Strategic Emerging Industries (SEI), Sci-Tech Innovation 2030, Internet Plus, and Made in China 2025.

China is now adopting priority technologies such as the “Internet of things,” “big data,” and smart manufacturing to move higher in the production value chain and several key sectors. There are some 75 priority technologies, almost 60 more than in the previous plan. Take, for instance, robotics. By

year-end 2016, China was on course to triple its annual production of robots to 100,000 in five years.

In the process, the role of advanced manufacturing, modern services and strategic emerging industries as a proportion of GDP will rise significantly in China. Now a record high R&D per GDP (2.5%) has been earmarked to fund scientific and technological R&D, to build science and technology programs, first-class national

science centers and technological innovation hubs, and help develop internationally competitive high-innovation enterprises.

In 2010, Chinese R&D as a share of the GDP was still relatively low (1.6%). By 2020, the figure will be higher than the EU average and at par with most advanced economies

(2.5%); and close to that of the US (2.7%).



WIPO Director General Francis Gurry presents the Global Innovation Index 2016 on August 15, 2016 at a press conference in the United Nations Office at Geneva. (Photo: WIPO)

### Rivalry for innovation leadership



After the devastation of Western Europe and Japan, U.S. exports dominated the world economy until reconstruction and revival in other major advanced economies. Historically, U.S. share of global

*While still the most innovative in the world, the U.S. defense leadership is no longer assured and is in danger of failing.*





## Global Innovation Index 2016: Top 10

Rank 2016 (2015)	Country/Economy	Score (0-100)	BRICS 		
1 (1)	Switzerland	66.28			
2 (3)	Sweden	63.57			
3 (2)	UK	61.93			
4 (5)	US	61.4			
5 (6)	Finland	59.9			
6 (7)	Singapore	59.16			
7 (8)	Ireland	59.03			
8 (10)	Denmark	58.45			
9 (4)	Netherlands	58.29			
10 (12)	Germany	57.94			
Rank 2016 (2015)	Country/Economy	Score (0-100)			
25 (29)	China	50.57			
43 (48)	Russia	38.5			
54 (60)	South Africa	35.85			
66 (81)	India	33.61			
69 (70)	Brazil	33.19			

As released in Global Innovation Index (GII) 2016, China breaks into the world's 25 most-innovative economies club - the only middle-income country in the top 25. The United States ranks 2 in GII 2016. (Photo: WIPO).

Note: The annual Global Innovation Index — released by WIPO (World Intellectual Property Organization), Cornell University, and the multi-nation business graduate school INSEAD — has been ranking world economies since 2007 according to their innovation capabilities using more than 80 indicators, including education, R&D, patent filings, knowledge and technology inputs and institutions.

manufacturing value added declined from 29% in the early 1980s to 19% in 2015. Since the burst of its asset bubble, Japan's share of global manufacturing has plunged to a third, or about 7%. In the same period, German exports were almost halved to less than 6%, despite relative benefits from the European sovereign credit crisis.

The declining export shares of advanced economies reflect the rapid increase of manufacturing activities in the large emerging economies, especially China, which replaced the U.S. as the largest manufacturing nation in 2010.

As a result, employment in manufacturing has fallen in most major manufacturing countries but risen in many large emerging economies over the past quarter-century. Due to the emerging economies' low-cost advantage and offshoring, which had taken off in the U.S. technology sector by the mid-80s, advanced

economies tend to focus more on higher value-added, which is their comparative advantage.

As the U.S. is now opting for a very different industrial policy, the net outcome could actually contribute to longstanding relative deterioration of U.S. innovation. That, in turn, could further contribute to the longstanding relative decline of U.S. innovation in both civilian and defense industries.

As evidenced by recent research, U.S. global innovation leadership continues to falter and is in danger of flat lining.<sup>[6]</sup> While still the most innovative in the world, the U.S. defense leadership is no longer assured and is in danger of failing. Due to the fact that defense innovation in the U.S. accounts for about half of total innovation, this decline not only has an impact on defense innovation and capabilities, but also overall commercial innovation and U.S. competitiveness.<sup>[7]</sup>

## Net outcomes by early 2020s?

In contrast to Obama, Trump hopes to facilitate U.S. growth with a “pro-growth tax reform,” and re-negotiated or rejected trade deals to “bring good-paying jobs to our shores and support American manufacturing, the backbone of our economy.” His hope is to unleash economic growth, and to create 25 million new jobs.

In reality, the reliance on new policy instruments (lower taxes, aggressive deregulation, new energy exports), may boost U.S. economic fortunes in the short-term but contribute to broader deterioration in the long-term (deeper income polarization, social costs of misguided deregulation, environmental hazards associated with forceful shale extraction). Sustained high-growth performance is highly unlikely to return – and the same goes for large-scale job-creation.

Paradoxically, the Trump administration seems to be trying to achieve progress in secondary priority areas, where it is destined to generate minimal or transient progress, while ignoring viable advances in those areas of competitiveness and innovation, where it could thrive.

If this proves to be true, then China may not just be positioned to reap the benefits from its accelerated secular reforms – but also from those of US policy mistakes.

*Sustained high-growth performance is highly unlikely to return – and the same goes for large-scale job-creation.*

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# As RMB's Role Grows, Could the U.S. be Left Behind?

If you ignore the dragon, it will eat you. If you try to confront the dragon it will overpower you. If you ride the dragon, you will take advantage of its might and power.



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The renminbi did not become fully convertible even for current-account transactions until 1996, and the Chinese government did not allow it to be used for trade invoicing prior to 2009. China's soaring monetary and financial influence since then is reflected in burgeoning offshore renminbi currency and bond trading in Europe as well as Asia. Swap arrangements for renminbi trade settlement with 30 countries and regions had been entered into by 2014 and companies like Korea's Samsung and France's

Alstom have adopted renminbi payment settlement in their Chinese subsidiaries. The United States' participation in renminbi internationalization remains conspicuous by its absence, however, notwithstanding that the People's Republic of China is not only its second-largest trading partner but also its largest creditor.

The Bank for International Settlements data revealed that the renminbi's share in global currency turnover rose from 1% in 2010 to 2% in 2013 and 4% in



*There is already speculation that at some point the renminbi could even supplant the dollar's role as the numeraire for international commodity trading and such a shift would be akin to the dollar's own replacement of the sterling as international reserve currency after the Second World War.*

2016. Although obviously well behind the dollar's dominant 88% share, this nevertheless reflects spectacular growth over a short period of time and the renminbi was already the eighth-most-traded currency in the world by 2016. The renminbi's inclusion in the IMF's special drawing rights basket of currencies will only further boost its appeal as a settlement currency. Indeed, the renminbi's initial basket weight of 11% puts it ahead of the pound sterling and Japanese yen and behind only the euro and U.S. dollar. Its placement ahead of the Japanese yen could itself be interpreted as pricing in an expanded future role for the renminbi, given that the yen's current share in global currency turnover today (22% in 2016) is much higher.

There is already speculation that at some point the renminbi could even supplant the dollar's role as the numeraire for international commodity trading and such a shift would be akin to the dollar's own replacement of the sterling as international reserve currency after

the Second World War. The renminbi has already begun to find a place among the reserve holdings of foreign central banks, a development fueled not only by China's growing economic strength but also the relative weakness of the euro. The dollar's role remains supported by its position as the primary "flight to safety" currency, at least for now.

Major prior steps in the internationalization of China's currency include the establishment of an offshore renminbi market in Hong Kong in July 2010, the November 2014 Shanghai-Hong Kong Stock Connect Program, and the December 2016 Shenzhen-Hong Kong Stock Connect Program. Renminbi-based transactions in Hong Kong exploded after the offshore market was formally established and the renminbi has also been increasingly displacing Hong Kong foreign currency holdings of dollars and euros. Meanwhile, direct investment flows between the two markets were facilitated by the more recent Stock Connect programs. Looking beyond East Asia, China

*It is imperative that the Chinese authorities continue to loosen capital controls rather than retightening them.*



has been Australia's most important export market since 2009 and companies like Australia's Fortescue Metal Group have begun transacting in renminbi. Further financial liberalization is needed in order for the renminbi to realize its potential, however. Recent currency weakness has been accompanied by declining Chinese overseas direct investment and such direct investment was down almost 40% in December 2016 relative to the prior year. It is imperative that the Chinese authorities continue to loosen capital controls rather than retightening them.

The substantial scope for expanding the renminbi's external role remains evident in the major inroads it has already made outside Asia. London, in particular, has become the most important external renminbi center beyond Hong Kong, overtaking Singapore in renminbi clearing volumes in 2016. There were more than 95 renminbi-denominated bond issues listed on the London Stock Exchange in 2016, raising approximately \$6 billion in aggregate. A potentially major additional step is currently under consideration in the form of a feasibility study for a new Shanghai-London Stock Connect Program that would, for the first time, provide European investors with direct access to mainland Chinese stocks. Nor is London the only European renminbi hub. Frankfurt's China Europe International Exchange was launched in November 2015 as a joint venture between the Shanghai Stock Exchange, Deutsche Börse and China Financial Futures Exchange. Luxembourg also has a

*Nor is London the only European renminbi hub.*

heavy concentration of renminbi-denominated funds.

Another element in renminbi internationalization concerns growing ties between China and the other BRICS nations of Brazil, Russia, India, and South Africa. The BRICS group, which has been moving away from the use of third-party currencies like the U.S. dollar and the euro in international trade settlement, added formal ties in 2015 via their New Development Bank and Contingent Reserve Arrangement. Although the UK's Brexit vote of June 2016 was widely seen as damaging the prospects for the euro, this may present a more unified BRICS group with an opportunity to benefit from a weakened European Union. Interestingly, the BRICS stock markets all fell significantly less than the -4.7% average global benchmark decline on the day after the UK referendum. Among the small group of countries enjoying positive abnormal returns on June 24, 2016, the two top performers were both part of the BRICS group – with Brazil enjoying an abnormal return of 5.5% and Russia 5.3%.

Even as much of the world becomes better positioned to take advantage of the dragon's might and power in line with the old Chinese proverb, the United States has done little more

than repeatedly debate whether or not China should be branded a “currency manipulator.” This charge is itself hardly supported by data on China’s current-account surplus, which declined to a rather modest 2.1% of Chinese GDP in 2016. It is still quite possible that congressional concerns with both the level of Chinese exports and penetration of the U.S. market by Chinese firms will provoke protectionist policies under the Trump administration. On the other hand, the potential mutual gains from engaging more positively with China should be abundantly clear to President Trump himself, given that the Industrial and Commercial Bank of China represents the Trump Tower’s biggest source of revenue – serving as its largest tenant and paying more per square foot than any other major office tenant in the building.

Ironically, at the very time that growing Chinese influences on other nations are enhancing economic interdependence and connectedness, the United States seems intent on more isolationist strategies, as reflected by the retreat from international agreements like the Trans-Pacific Partnership. Such actions only open the door further to China, including the potential for China playing a dominant role in the

fledgling Regional Comprehensive Economic Partnership. The RCEP covers the 10 members of the Southeast Asian group ASEAN plus China, Australia, India, Japan, New Zealand and South Korea. There is every possibility that a U.S.-led Trans-Pacific Partnership could be effectively replaced by a China-led RCEP, which would represent a regional trade bloc covering near 27% of global trade. Given how far China’s monetary reach has extended already, the challenge to U.S. leadership certainly seems to be already underway. The United States must be careful not to be left out in the cold.

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# Real China-U.S. Trade Balance

The China-US trading relationship is the largest, and perhaps most consequential, trade relationship in the world, dramatically impacting global economic and political stability.

The China-US trading relationship is the largest, and perhaps most consequential, trade relationship in the world, dramatically impacting global economic and political stability. In particular, the bilateral trade balance remains a hotly debated issue between and beyond the two countries: the latest Chinese data show a U.S. deficit of US\$261.4 billion in 2015, while U.S. data show US\$367.4 billion, revealing a huge discrepancy of more than US\$100 billion. However, neither of these numbers represent the full and actual trade balance and the relative

benefit between the two countries. A more nuanced approach that includes additional perspectives shows that the true U.S. deficit may be as low as US\$132.7 billion.

To better understand the reality of the bilateral trade relationship, it is helpful to first understand why differences exist between official Chinese and U.S. trade statistics regarding the China-US trade balance in goods and services. First, the international conventions of measuring exports of goods differ from the conventions for measuring



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imports. Exports are valued on an FOB (free on board) or FAS (free alongside ship) basis, while imports are valued on a CIF (cost, insurance and freight) basis. Practically, this means that the value of imported goods as measured by the importing nation is always higher than the same goods as measured by the exporting nation. Thus, Chinese exports of goods to the U.S. according to Chinese official statistics is always less than U.S. imports of goods from China according to U.S. official statistics, by approximately 10 percent, the difference between CIF and FOB valuations.

Second, Chinese exports of goods to the U.S. according to Chinese official statistics include only direct exports to the U.S. but not re-exports to the U.S. through Hong Kong, whereas U.S. imports of goods from China according to U.S. official statistics include Chinese re-exports through Hong Kong because the U.S. applies its rules of origin with regard to imports. Similarly, U.S. exports of goods to China according to U.S. official statistics do not include re-exports of U.S. goods to China through Hong Kong.

However, there are additional gaps and challenges that prevent the official statistics of both countries from presenting the full picture of the trade relationship. For instance, the increasingly important trade in services between China and the U.S. is often not included. Additionally, the real benefit that exports bring to an economy is the domestic value-added (GDP) that it generates, both directly and indirectly, and not its gross value. Thus a more appropriate measure of the relative benefits is the trade balance in terms of value-added.

To achieve a more accurate view of the U.S.-China trade balance, our recently released report titled, *Adjusted China-US Trade Balance*, takes several steps to circumvent the causes for these discrepancies and misrepresentations.

First, we re-estimated the China-US trade balance by relying only on the export data of each country. This avoids the distortions that may arise because of the different conventions used in the measurement of exports (FOB) and imports (CIF). By relying only on the export data of both countries, the estimated China-US trade balance is higher

*Practically, this means that the value of imported goods as measured by the importing nation is always higher than the same goods as measured by the exporting nation.*



than the official Chinese figure and lower than the official U.S. figure. For 2015, the estimate of the China-US trade balance based on export data is US\$291.3 billion, between the Chinese figure of US\$261.4 billion and the U.S. figure of US\$367.4 billion.

Next, we adjusted the China-US bilateral trade data for re-exports through Hong Kong. Re-exports through Hong Kong have declined significantly in recent years. Chinese re-exports to the U.S. through Hong Kong have declined from its peak of 196% of direct exports to the U.S. in 1991 to only 8% in 2015. Similarly, U.S. re-exports to China through Hong Kong has declined from its peak of 44% in 1996 to only 7% in 2015. However, with the adjustment for re-exports through Hong Kong, the estimate of the China-US trade balance is increased from US\$291.3 billion to US\$317.4 billion.

We then sought to incorporate the bilateral trade in services. The U.S. publishes bilateral data on trade in services, while unfortunately China does not currently publish such data. According to U.S. data, U.S. exports of services to China has grown rapidly, to US\$48.4 billion in 2015, compared to Chinese exports of services to the U.S. of US\$15.1 billion, resulting in a surplus of US\$33.3 billion for the U.S. However, fragmentary Chinese data

suggest that the U.S. surplus in trade in services was higher, amounting to approximately US\$45 billion in 2015. The U.S. surplus in trade in services is likely to continue increasing for a long time because of the rapidly rising total expenditures of Chinese students and tourists in the U.S. and the possibility of the expansion of U.S. financial services in China. Including services, in terms of gross value, the China-US trade balance is reduced from US\$317.5 billion to US\$284.1 billion in 2015, based on U.S. official data. If the alternative estimate of U.S. surplus in trade in services of US\$45 billion is used, the China-US trade balance is further reduced to US\$272.1 billion, still a very substantial number.

Finally, the gross value of exports of goods and services combined is not a reliable measure of the benefits to the exporting country. For example, while most Apple iPhones are assembled in China, the value-added in China is no more than US\$20 for each iPhone, even though it is exported for approximately US\$500, with a value-added to gross value ratio of 4%. Therefore, a more useful indicator of the net benefit for the exporting country is the domestic value-added (or equivalently, the GDP) generated directly and indirectly by the exports. We estimated the value-added corresponding to the exports of goods and services of both China and the U.S.

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*For example, while most Apple iPhones are assembled in China, the value-added in China is no more than US\$20 for each iPhone, even though it is exported for approximately US\$500, with a value-added to gross value ratio of 4%.*

in 2015 by using input-occupancy-output tables of both countries. The domestic value-added of Chinese exports of goods to the U.S., which has a gross value of US\$443 billion, was only US\$285 billion, whereas the domestic value-added of U.S. exports of goods to China, with a gross value of US\$126 billion, was US\$108 billion. We may note that the domestic value-added content of U.S. exports was much higher than that of China.

To summarize, by including re-exports through Hong Kong, the China-US trade balance is increased from US\$291.3 billion to US\$317.5 billion. By including trade in services, the China-US trade balance is reduced from US\$317.5 billion to between US\$284.1 billion and US\$272.1 billion. By considering value-added instead of gross value, the China-US trade balance in goods alone, including re-exports, may be estimated to be US\$176.9 billion (down from the estimate of US\$317.5 billion based on adjusted

gross value of export FOB data). If the bilateral trade in both goods and services are included, the China-US trade balance in terms of value-added may be estimated to be between US\$145.0 billion and US\$132.7 billion in 2015.

As can be seen, the 2015 Chinese trade surplus is still substantial after all these adjustments, but is significantly reduced from the initial estimate of US\$367.4 billion based on U.S. data on the trade in goods to an estimate as low as US\$132.7 billion based on the value-added on the exports of goods and services of China and the U.S. to each other. By re-examining the China-US trade balance, it is clear that typically cited numbers may not accurately reflect the relative benefit of the China-US trade relationship.

*If the bilateral trade in both goods and services are included, the China-US trade balance in terms of value-added may be estimated to be between US\$145.0 billion and US\$132.7 billion in 2015.*

# Goals for a Code of Conduct

Like the confidence-building measures that have maintained peace and stability along the disputed China-India border, a code of conduct agreement with ASEAN will smooth relations and invite new cooperation — without regard to the Philippines' improper and unilateral appeal for outside arbitration.



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Chinese Vice Foreign Minister Liu Zhenmin confirmed in early January that negotiation on a code of conduct (COC) framework on the South China Sea had entered a very important phase and a draft could be finished by June. Such remarks can only be pleasant news for ASEAN, which – since the negotiations started in 2013 – has wished that China could agree to speed up the negotiation.

However, in 2013, the Aquino government of the Philippines unilaterally took the arbitration to the international maritime tribunal, without consulting China or informing ASEAN. It is only now that the situation allows for speeding up such talks, thanks largely to President Rodrigo Duterte's efforts in ameliorating the poisoned relations between the two countries.

What could the framework

*Beijing has made it crystal clear that the ruling, which China refuses to accept, cannot be the basis of any discussions.*

look like? Almost certainly it won't mention the tribunal's ruling at all, however disappointing this may be to some people. Beijing has made it crystal clear that the ruling, which China refuses to accept, cannot be the basis of any discussions. When Aquino government initiated the arbitration against China, ASEAN didn't agree, but it failed to make efforts to stop such a unilateral move, which is a violation of the China-ASEAN consensus. The 2002 Declaration on the Conduct of Parties in the South China Sea (DOC) obligates "sovereign states directly concerned" to resolve their disputes through "friendly consultations and negotiations" rather than resorting to legal procedures.

ASEAN's major focus might be on two principles laid out in the DOC. One is "to resolve disputes without resorting to the threat or use of force"; another is "refraining from action of inhabiting on the presently uninhabited islands, reefs, shoals, cays, and other features". Given China's military strength and Chinese land-reclamation in the South China Sea, such concerns on the part of ASEAN seems understandable but

not really justifiable. China has never threatened to use force to take back the 29 islands and reefs currently occupied by other claimants even though China believes they are Chinese territories. China's land reclamation is only conducted on Chinese-controlled islands and reefs. So far the only country using force after 2002 DOC was signed was the Philippines: Its coast guard killed Chinese mainland and Taiwanese fishermen in 2006 and 2013.

The DOC comprises two indispensable parts. One is confidence-building measures, the other is practical maritime cooperation. On confidence building, the evolving COC should reflect and, more importantly, carry out the outcomes in early consultations such as bilateral agreement in setting up "a China-ASEAN hotline platform for maritime search and rescue" and "a China-ASEAN senior foreign officials' hotline platform on emergencies". During the Xiangshan Forum in November 2015, Chinese Defense Minister General Chang Wanquan proposed setting up a China-ASEAN defense hotline, which was warmly

*The DOC comprises two indispensable parts. One is confidence-building measures, the other is practical maritime cooperation.*





*Senior officials from China and ASEAN attend the 13th Senior Officials' Meeting on the Implementation of the Declaration on the Conduct of the Parties in the South China Sea (DOC) in China's Manzhouli on Aug. 16, 2016. They reaffirmed plans to solve disputes on the South China Sea through negotiations and by using a regional framework of regulations. China is to host in May a meeting with ASEAN members to discuss COC.*

received by ASEAN defense ministers. China and ASEAN have agreed to conduct a naval exercise to avoid unplanned encounters at sea in 2017. China and Vietnam have already established two hotlines at governmental and military levels. The two navies have conducted joint patrols in the Beibu Gulf (Gulf of Tonkin).

The bigger challenge is how the COC could include concrete efforts in maritime cooperation identified in the DOC, namely, marine environmental protection; marine scientific research; safety of navigation and communication at sea, search and rescue operation and combating transnational crime.

After all, both China and ASEAN agree that resolving territorial disputes is not and should not be the whole of China-ASEAN relations. Cooperation should go in tandem with crisis management. In 2011, China established a fund of 3 billion RMB for maritime cooperation with ASEAN. So far some progress has been made, such as signing a Memorandum of Understanding on the establishment of the China-Malaysia Joint Oceanographic Research Center, the establishment of the China-Indonesia Center for the Oceans and Climate and the Joint Oceanic Observation Station. But all these projects are still in early stages. They have yet to grow and bear fruit.

Could China and ASEAN talks on COC proceed smoothly and finish by June as planned? The tempo in no small way depends on the changing situations in the South China Sea. Rex Tillerson, President Trump's secretary of state, made a statement at his confirmation hearing directly to Beijing: "your access to those islands is not going to be allowed". Does he mean the US under the Trump administration wants a war with China? Even if this is an inadvertent slip of tongue, it is highly irresponsible. China's removal of an unidentified object on Dec 15, which later proved to be a US unmanned underwater drone, shows that China not only has a duty for the safety of navigation and personnel of passing vessels, but also that in the South China Sea, it is not up to the US to unilaterally interpret what freedom of navigation means.

A COC is not about delimitation of maritime boundaries among the claimants, which can only be the final target. Although it is a big step forward from the DOC, it is still about confidence building. It may not solve problems but it helps to prevent problems from escalating. A useful reference is how confidence-

building measures have worked along the China-India border. Although the border dispute there remains unsolved to date, peace and stability have by and large been maintained through implementation of a series of agreements and confidence-building measures. The miracle is, for over half a century, not a single bullet has been fired across the border.

*After all, both China and ASEAN agree that resolving territorial disputes is not and should not be the whole of China-ASEAN relations.*

# Tillerson's Brush with South China Sea History



Mr. Tillerson betrays a lack of understanding of the U.S. position on the sovereignty claims in the South China Sea. As a matter of policy, the U.S. takes no position – and hasn't for decades – on these rival claims. If the Secretary of State has the chance to encounter 96-year Li Jingsen on his next visit to Beijing, he might learn that the warships sent by China to recover the islands in 1946 were even provided by the United States.



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On February 1, 2017, Rex W. Tillerson was sworn in as America's top diplomat after a tight confirmation vote that garnered the largest opposition in the U.S. Senate's history for an incoming secretary of state.

As a globe-trotting, ex-Fortune 500 CEO, Mr. Tillerson passes for one of the rarer sensible types within an administration that has worn its lack of restraint and judgment as a badge of honor. Little of that sense was in evidence though at his confirmation hearing on January 11. In a mere 162 words of prepared remarks on China, Mr. Tillerson misstated international law as well as U.S. policy on Beijing's island-building activities in the South China Sea. Pressed to clarify, he compounded this ignorance with a set

of belligerent policy suggestions, including denying China physical access to its own islands, which if enforced could leave the Asia-Pacific at the doorstep of war.

Although it appears that Mr. Tillerson has since tempered his remarks, as secretary of state he must speak and act more cautiously.

China is fully within its legal rights to construct artificial islands on the high-tide features that it administers in the South China Sea, as well as on those submerged features that lie within the territorial sea of a high-tide feature that it administers or claims in these waters. Such construction is not an encroachment or “illegal taking of disputed international territories” – much less a violation of the undisputed territorial sovereignty of a neighboring state “akin to Russia’s taking [of] Crimea” from Ukraine in 2014.

Mr. Tillerson’s remarks also betray a lack of understanding of the U.S. position on the sovereignty claims in the South China Sea. As a matter of policy, the U.S. takes no position – and hasn’t for decades – on these rival claims. And on the one occasion that it did in fact throw its full diplomatic weight behind a claimant’s position, the State Department and its adviser, John Foster Dulles, came down on the side of (the Republic of) China.

On September 8, 1951, at the San Francisco Peace Treaty conference, Japan renounced all right, title and claim to Korea, Taiwan and Penghu, the Kurile Islands, South Sakhalin, the League of Nations-mandated Pacific Islands, and the Spratly and Paracel Islands. On April 28, 1952, hours before these renunciations was to come into force, the Yoshida government renounced Taiwan, Penghu and the Spratly and Paracel Islands in a bilateral Treaty of Peace (Taipei Treaty) with Chiang Kai-shek’s Nationalist government in Taipei.

The timing of the Taipei Treaty was not a coincidence – it was meticulously scripted by the State Department’s Dulles. A month prior to the San Francisco conference, Dulles had resolved to restore to Japan after its signature on the San Francisco Treaty *but before its coming into force*, all the freedoms contemplated by the treaty except sovereignty with respect to military matters. For Chiang too, the signature on the Taipei Treaty prior to the coming into force of the San Francisco Treaty represented a victory of sorts: It preserved his government’s status, and face, as representing one of the victorious war-time allies.

Nor was the Taipei Treaty’s content a coincidence. By late-December 1951, Dulles had spelled out the key treaty provisions that Prime

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*The inclusion of the Spratly and Paracel Islands in the territorial provisions of the treaty – and thereby signaling Washington and Tokyo’s favorable opinion of Chiang’s claim to these islands – was not the point of contention.*

Minister Yoshida was instructed to offer Generalissimo Chiang and re-establish normal relations between the two governments. The inclusion of the Spratly and Paracel Islands in the territorial provisions of the treaty – *and thereby signaling Washington and Tokyo’s favorable opinion of Chiang’s claim to these islands* – was not the point of contention. That pertained instead to the contingent sovereignty over the scope of territories controlled by Chiang that the U.S. and Japan were prepared to recognize. Only nationals and juridical persons who resided in or were registered on territories under his current or future sway were to be recognized as falling under the Republic of China’s sovereignty.

This was done so that if Nationalist forces were ousted from territories they currently held (the U.S.-Republic of China Mutual Defense Treaty was only signed in December 1954), there could be no legal basis, stated or implied, for the People’s Republic of China to claim sovereignty over Taiwan, Penghu, and the Spratly and Paracel Islands. To this day, the U.S. does not accept or reject the claim that Taiwan is a part of China and, under this pretext, claims its intrusion into cross-straits affairs is technically

not an interference in the internal affairs of China.

It is for this reason too that the future title of Taiwan, Penghu, and the Spratly and Paracel Islands was left undetermined in the San Francisco Peace treaty as well as in the Taipei Treaty. Japan renounced these territories but left their final disposition suitably vague so that these territories would not legally devolve to a “hostile regime ... that could enable [it] to endanger the [U.S. Seventh Fleet’s] defensive position which is so vital in keeping the Pacific a friendly body of water.” Indeed, as early as June 27, 1950, just two days after the outbreak of the Korean War, it became the policy of the Truman Administration to punt the question of Taiwan’s status out into the indefinite future.

America’s legal legerdemain regarding the Taiwan Question is disingenuous. None of this should obscure the argument though that on the one occasion when the Spratlys and Paracel Islands’ disposition was actively considered at the multilateral level, the U.S. favored (the Republic of) China as the superior claim-holder.

It is worth observing that the Japan-Republic of China peace treaty, being a bilateral treaty, cannot bind non-signatories. Whether Japan even enjoyed the authority in the first place to transfer title in San Francisco and in Taipei isn't clear either. Unlike the case of Taiwan and Penghu, whose title Tokyo could trace to the late-19th century Treaty of Shimonoseki, the Spratlys were forcibly occupied in the late-1930s. For its part, Beijing has had harsh things to say about the San Francisco Peace Treaty. Unjustly excluded from the conference as well as the consultation processes that preceded it, Beijing traces its claim to these land features to the war-time Cairo and Potsdam Declarations, which was confirmed in Article 3 of its September 1972 normalization agreement with Tokyo.

This having been said, no other claimant state in the South China Sea can produce a Spratlys and Paracels renunciation or reversion clause in its own post-war bilateral normalization agreements with Japan. The Philippines was wholly concerned at the time with the issue of reparations and France, even as late as 1956, was absorbed with claiming the Spratlys for itself – not on behalf of Vietnam.

On December 8, 2016, at a ceremony in Beijing to commemorate the 70th

anniversary of China's landing and recovery of the South China Sea islands, 96-year Li Jingsen recounted his role on board the *Yongxing*, one of the vessels that had led the operations. If Mr. Tillerson has the chance to encounter Mr. Li on his next visit to Beijing, he might learn that the warships sent to recover the islands in 1946 were even provided by the United States. China and the claimant states have made valuable progress in bilateral ties since the ASEAN Foreign Ministers' Meeting (AMM) in Vientiane, Laos last July. The Trump Administration should support – not disturb – the progress made so far.

*If Mr. Tillerson has the chance to encounter Mr. Li on his next visit to Beijing, he might learn that the warships sent to recover the islands in 1946 were even provided by the United States.*

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Based in Hong Kong, the China-US Exchange Foundation was established in 2008 by individuals who believe a positive relationship between the strongest developed nation and the most populous, fast-developing nation is essential for global wellbeing. The Foundation is a non-government, non-profit entity and is privately funded.

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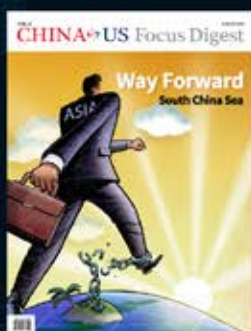
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