

Building New Momentum



CHINA US Focus

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Publisher

Alan Wong

Editor

Zhang Ping

Special Advisor

Zhu Yinghuang

Assistant Editor

Peng Hui

China-US Focus Digest is a bi-monthly magazine of exclusive commentaries on China-US relations. The articles express views of influential opinion leaders and scholars in China and the US on the issues faced by the two nations. Its contents are independent and do not necessarily reflect the views of the China-US Focus team.

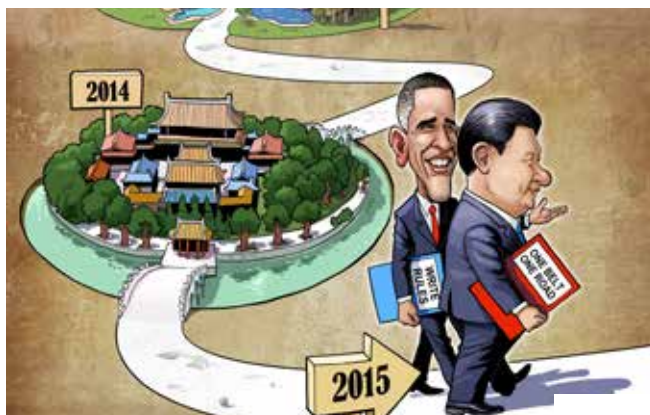
@ China-United States
Exchange Foundation, 2015

For comments, please send to
chinausfocus@cusef.org.hk



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Chairman's Message

TUNG CHEE HWA

As we enter the New Year, for many of us who have devoted ourselves to improving US-China relations, we will look back to the year 2014 with a degree of satisfaction. The November state visit by Mr. Obama to Beijing was a resounding success. Not only were the two presidents able to continue a relaxed, private and frank discussion over many hours, as they did at Sunnylands, California in June 2013, but the state visit also reconfirmed the two country's commitment to building a new power relationship. This is not only important for the two countries, but also for the world at large.

Specifically, the two leaders have reached a series of agreements that will noticeably benefit people of the two countries. These include an agreement on the expansion of negotiations on the existing Information Technology Agreement (ITA); an agreement on climate change; and an agreement between the two militaries to deepen mutual trust and reduce misjudgments. There is also an agreement to increase on people-to-peo-

ple exchanges that gives green light to issue 10-year, multiple-entry visas for respective business travelers and tourists, and 5-year, multiple-entry visas for each other's students. All these agreements marked the significant development of the bilateral relations.

Indeed, common interest will bind our relationship closer. Working together, we can secure peace and prosperity for our two countries for years to come. But we have to recognize that differences do exist between the United States and China. After all, the two countries have different histories, different cultures, different values and different political systems. Furthermore, we are at different stages of development, and therefore our needs are different. Indeed differences will manifest themselves from time to time. But differences need to be managed, and can be managed. It is obvious that conflict between the two countries will result in unthinkable consequences for both. Therefore, it has been emphasized by the two countries that the new power relationship is built on the basis that the two countries commit not to confront each other, and not to enter into conflict with each other.

However, for this relationship to move further forward, continued efforts at building trust and understanding between the people of the two countries is essential. In 2015 and the years beyond, the Foundation will continue in this effort.

A handwritten signature in black ink, which appears to read 'Tung Chee Hwa'. The signature is fluid and stylized, with a long horizontal stroke at the end.

Tung Chee Hwa
Chairman

China-United States Exchange Foundation

3 February 2015



Editor's Note

ZHANG PING

The first issue of China-US Focus Digest in this New Year focuses on an “Outlook for China-U.S. Relations in 2015.” Key concepts in the articles include, “A Degree of Satisfaction,” “Maintaining and Building a New Momentum,” “the New Normal,” and “the Larger Picture.” A wide-range of experts, scholars, and China-watchers has chimed in on the state of bilateral relations.

Our contributors from the U.S. and China all hope that the leaders of the two countries can communicate effectively on complex problems, as they did at the Beijing Summit last November. When delivered in good faith, such negotiations could not only strengthen the foundation of the China-U.S. relationship, but also build strategic trust on global issues of mutual concern.

Richard Weitz commented that President Barack Obama’s recent State of the Union Speech omitted mention of security concerns with China, thereby reaffirming U.S. security policies and reflecting the general American belief that relations with China encompass a manageable blend of cooperation and competition.

On the establishment of a “New Type of Great Power Relations,” Chen Li and Lucy Xu from the Brookings Institution offered explanations for Chinese enthusiasm and American cynicism toward the concept initiated by the Chinese President Xi Jinping in 2012. They suggested that China should advance the interests of smaller nations in the Asia-Pacific, and the U.S. should move beyond its Cold War, realist mentality.

On business issues, we selected articles that shed light on the “New Normal” of China’s economy, the Asian Infrastructure Investment Bank, and the impact of China’s growing direct investment in the U.S. We think these articles provide relevant analysis on China’s current economic situation.

And finally, a message from Mr. Tung Chee Hwa, Chairman of the China-United States Exchange Foundation, from the Foundation’s 2014 Annual Report, in which he reviews China-U.S. relations from the past year and stresses that in order to further progress this bilateral relationship, continued efforts to build trust and understanding between the peoples of the two countries is essential.

Our mission to deliver a comprehensive overview of facts on China-U.S. cooperation, analysis of current economic and political developments, and expert opinions on bilateral relations, will undoubtedly continue in this effort.

U.S.-China Relations in 2015

Building New Momentum



David Shambaugh

Professor, George Washington University

After several years of drift and decline, the US-China relationship ended 2014 modestly improved. The central task going into a new year is to build on this new momentum to strengthen the foundation of the relationship, build strategic trust, and work in tandem (or in parallel) on global issues of mutual concern.

After several years of drift and decline, the U.S.-China relationship ended 2014 modestly improved. The presidential summit in Beijing in November not only produced several important and tangible accomplishments (see: <http://www.chinausfocus.com/foreign-policy/a-step-forward-in-us-china-ties/>), but more importantly it stabilized the relationship (at least temporarily) and created a more positive atmosphere. The recently concluded Joint Commission on Commerce and Trade (JCCT) added further to enhancing the bilateral relationship.

The central task going into a new year, therefore, is to build on this new momentum in order to strengthen the foundation of the relationship, build strategic trust, and work in tandem (or in parallel) on global issues of mutual concern.

While we hope that the new stabilization and momentum coming out of the Obama-Xi summit is not temporary (as was the case following the Obama-Hu Jintao 2011 summit), it will require hard work and consistent effort on both sides to capitalize on the new gains made in Beijing in November.

Perhaps the most immediate opportunity—and one that would give an enormous boost to the relationship—would be an early conclusion of the Bilateral Investment Treaty. Early in the New Year the two governments are due to exchange draft “negative lists” of sectors which would be off-limits to investment from the other country. The fact that there will be such sectors is inevitable—the operative questions are which ones and can they be harmonized? This is likely to produce some of the toughest negotiations in the US-China relationship since China’s WTO entry negotiations nearly two decades ago. But they

need not be as protracted as the WTO negotiations, and can hopefully be brought to fruition quickly and efficiently. Both nations stand to benefit a great deal from further opening to bilateral investment.

The central task going into a new year, therefore, is to build on this new momentum in order to strengthen the foundation of the relationship, build strategic trust, and work in tandem (or in parallel) on global issues of mutual concern.

Also on the agenda in the year ahead will be TPP (the Trans-Pacific Partnership). Of course, China is not a party to those negotiations—but if they are concluded successfully and TPP comes into being China will have significant incentives to conform and comply with the standards set, even as it pursues its own vision of a Free Trade Area of the Asia-Pacific (an initiative Xi Jinping announced at APEC). Joining TPP would have the same positive systemic impact on the Chinese economy that joining the WTO did fourteen years ago, as it would jar many of the entrenched institutional interests (particularly in the financial and state industrial sectors, but also in energy, transport, and telecommunications). In all of these sectors, China’s economy is essentially closed and protected—joining TPP and phasing in the high (and open) standards that TPP is expected to establish will be an enormous

jolt to these sectors, but that is just what they need if China is to realize its own Third Plenum economic goals.

Continuing the deepening of military exchanges is also high on the agenda. In 2013 and 2014 we witnessed the broadest and deepest set of “mil-mil” exchanges in 25 years, and this new investment needs to be built upon. This will require, on the American side, revision or retraction of the 2000 Defense Authorization Act—which places a range of restrictions on what the Pentagon can do and not do in its exchanges with the People’s Liberation Army. The US and Chinese militaries are at the heart of strategic interactions between the two nations, and all efforts must thus be made to deepen the interactions and communications between the two military establishments.

A third set of issues high on the agenda will be to forge practical cooperation on a number of so-called “global governance” issues—including counter-terrorism, anti-piracy, climate change, maritime security, economic stability, energy security, food security, and setting global rules for cyber activity. Whether Washington and Beijing work in tandem to address these issues, or work on separate but parallel tracks, such cooperation is critical to addressing these international challenges. To date, China has been extremely reluctant to collaborate openly with the United States on such global governance issues (despite a decade of American government attempts to enlist such cooperation from Beijing), but now it possibly seems more feasible. This is because President Xi Jinping has personally endorsed more “proactive diplomacy” (积极外交) by China in the global governance arena. As the world’s No. 2 power, China needs to be much more fully engaged in global governance and be seen to be contributing at a level commensurate with its considerable capabilities. It is no longer sufficient to free-ride or selectively engage. Chinese diplomacy needs to substantially increase and

improve its global governance contributions in 2015.

Finally, as President Obama enters his last two years in office and facing a Republican majority in both houses of Congress, he will likely be perceived increasingly as a “lame duck” by the Chinese government (and other nations). This may be a fact, but it would be a mistake to not work with his administration in building on the momentum established in Beijing in November 2014 and to expand the “zone of cooperation” in Sino-American relations (bilaterally, regionally, and globally). President Obama’s successor will be far better served if he/she inherits a relationship that is stable and as cooperative as possible.



What Comes Next In U.S.-China Relations

*Wang Dong, Robert
Kapp, Bernard Loeffke*

What the Xi-Obama November agreements suggest is that the two leaders are able to communicate effectively on complex problems, negotiate in good faith, and reach mature understandings that serve the interests of both countries. Now, the question is, can that pattern be maintained in 2015 and beyond?

On the evening of November 11, 2014 in Beijing, just after the 21-nation APEC meetings, Chinese President Xi Jinping hosted U.S. President Barack Obama at an “informal” dinner and tea-drinking inside the Zhongnanhai leadership compound. A formal state visit by President Obama brought the two leaders together for much of the following day. The two presidents then announced a wide range of bilateral agreements covering climate change, visa facilitation measures, as well as military to military relations.

The throng of pundits who had prognosticated about the Xi-Obama meetings had not foreseen Sino-American agreement on so many issues.

The positive outcomes of the summit seemed to call into question the widely assumed wisdom that U.S.-China relations were locked into a widening downward spiral. To some observers, the agreements reached in Beijing recalled the optimism emanating from the “Sunnylands Summit” in California in the summer of 2013.

In the lead-up to the Beijing meetings, we wrote in the *New York Times* that in light of the growing mutual distrust in both countries, the two presidents should seize the opportunity of the summit to reassure each other about their nations’ respective strategic intentions, and work together to ease the suspicions that each side harbored toward the other. We were gratified

that Xi and Obama seemed to have done just that in Beijing.

What the November agreements suggest is that the two leaders are able to communicate effectively on complex problems, negotiate in good faith, and reach mature understandings that serve the interests of both countries. Now, the question is, can that pattern be maintained in 2015 and beyond? The disenchantments that crept onto the stage after Sunnylands offer grounds for concern, but we believe that the chances of continued positive momentum are good nevertheless.

To maintain forward movement in the relationship, both presidents and their foreign policy teams will have to provide continuing assurance to each other, concentrate whenever possible on positive messages, and, as always, carefully manage their differences even as they expand areas of practical cooperation wherever possible.

That means, first of all, that the November agreements must be implemented energetically and fully, both in the short and in the longer term.

The climate agreement is the most cosmic, with the longest-term implications. The agreement is unprecedented; for the first time, China has committed to capping its CO₂ emissions by a date certain. The Beijing agreement, widely welcomed in the international community, should lay a foundation for the crucial 2015 Paris conference on climate change. China and the U.S., as the world's two largest emitters, have begun to show that they can address their unique leader-

ship responsibilities, promoting global emission reductions and battling global warming.

In the joint understanding regarding the WTO's "Information Technology Agreement," China and the U.S. finally broke a lengthy and frustrating impasse, opening the way to broader international agreement on the elimination of tariffs on a huge list of globally traded high technology items. Once again, though, the U.S. and China must continue to work with the global trade community to ensure that a final agreement is reached quickly. Roughly \$1 trillion worth of

trans-border trade is on the line. In a vast trading relationship inevitably characterized by frequent frictions, this agreement is a healthy reminder that economic engagement is likely to remain the ballast of the U.S.-China relationship.

Presidents Xi and Obama made positive noises in Beijing about the desirability of a Bilateral Investment Treaty (BIT), which could bring enormous economic opportunities and benefits for both countries and

indeed will greatly shape the trajectory of U.S.-China economic relations. Looking ahead, the two presidents, having reaffirmed their commitment during their summit, should energize their BIT negotiators, even if U.S. Congressional approval of a solid BIT will ultimately demand a dedicated effort by the White House and Congressional leadership.

Meanwhile, the two presidents agreed to facilitate the reconciliation and reconstruction process in Afghanistan. Going forward, the U.S. and China, along with other stakeholders, should present a joint vision for a secure and

What Mr. Xi Jinping and Mr. Barack Obama rolled out in Beijing, to the surprise of many observers, is an indication of how they and their administrations can – and should – continue to work together in the future.

stable Afghanistan, and lay out the parameters for a peace-building process that will see more substantive China-U.S. collaboration, as well as effective regional cooperation in achieving such a shared goal.

The two presidents have committed to join hands in the battles against the global terrorist threats. Now, the two presidents should direct their respective governments to embark on discussions about cooperation at both strategic and policy levels, including possible cooperation on intelligence sharing and legal cooperation, and on concerted efforts to assist the fight against the global terrorist threat through the United Nations (U.N.) as well as other multilateral frameworks.

On North Korea, the two presidents have reaffirmed their commitment to denuclearization. Now China and the U.S. should intensify their discussions, bilaterally and with other key stakeholders including Seoul and Tokyo, aiming to present Pyongyang with a unified and consistent international position and to seek a diplomatic solution to the North Korean nuclear challenge.

In terms of military to military relations, the summit produced two memoranda of understanding (MOU)—one on the notification of major military activities and another on rules of behavior for safety of air and maritime encounters. Here again, operationalizing these commitments, which entail complex technical and training challenges for both forces, will be the best “confidence-building measure” to come out of the Xi-Obama exchange, and will contribute to the promotion of what Chinese President Xi calls a “new model of military relationship”.

Overall, the Xi-Obama summit in Beijing has helped stabilize the China-U.S. bilateral relations and brought back positive momentum in bilateral relations. Opportunities for further progress abound, but success is not guaranteed. For each country, these commitments will require sig-

nificant adjustments and policy changes, which can only be brought about through domestic political processes. For both nations, this will be where domestic economic and political factors collide with the conduct of foreign policy.

In the U.S., incoming Congressional leaders, for example, immediately made clear their opposition to the climate agreement, questioning China’s credibility in keeping its promises and warning of potential job losses. Such instant condemnation of the Xi-Obama agreement on climate change is not helpful in assuring not only China but the world at large of America’s ability to carry through on the Beijing agreement.

In China, meanwhile, the commitment to cap CO₂ emissions, reduce overall coal use, and raise to twenty percent the share of overall energy production from sources other than fossil fuels, raises significant challenges for Chinese leaders. Arguably, the current anti-corruption campaign, part of which targets the vast powers accumulated by interest groups in the coal and oil sectors, will help facilitate China’s fulfillment of its new climate change commitment.

To sum up, by building on and sustaining the productive ties they announced in Beijing, the two presidents will have a good chance to build a new model of major country relationship and indeed lay the foundation for a deeper, mature, cooperative, and robust U.S.-China relationship in the decades to come. What Mr. Xi Jinping and Mr. Barack Obama rolled out in Beijing, to the surprise of many observers, is an indication of how they and their administrations can – and should – continue to work together in the future.

(Wang Dong is an associate professor at School of International Studies, Peking University; Robert A. Kapp, a former president of the US-China Business Council, is a senior adviser to the China Program of the Carter Center; Bernard Loeffke is a retired major general of the U.S. Army and was formerly a military attaché to the U.S. Embassy in Beijing.)



New Normals in China-U.S. Relations



Chen Yonglong

*Director, China
Foundation for Int'l
Studies*

Chen Yonglong explains the six “normal” states of interaction that will define the China-U.S. relationship: in redefining shared global power; in how leaders conduct dialogue; in economics; in strategic contention of hegemony and ideology; in their efforts to control dispute; and finally in their cycles of balance and rebalance.

The relationship between China and the United States in 2014 was marked by cycles of tension, détente, wrangling, and hard-earned progress. At times the tension was so high as to cause serious anxiety, and détentes came so suddenly as to

bring pleasant surprises. Obviously the bilateral relationship is maturing, giving rise to a number of “new normals.”



The first, and cardinal, “normal” is the new type of big power relationship between the two countries.

During his visit to the U.S. two years ago, the then Chinese Vice-president Xi Jinping proposed to establish a new type of relationship between the two countries, namely “no conflict, no confrontation, mutual respect and win-win cooperation.” Though full of misgivings, the U.S. side accepted the idea.

The new concept was raised in an attempt for the current superpower and the emerging power to avoid the Thucydides trap. History will prove that its significance can match that of Nixon and Mao’s decision in 1972 to establish diplomatic relations. Though it still lags behind the U.S. in many aspects, China is, after all, the world’s second largest economy, which is bound to become a greater contributor to global peace and development. And the U.S. will maintain its

growth momentum despite its relatively declining national strength, and will continue to be a responsible power in global affairs.

There is no denying that misunderstanding, tension, and even tit-for-tat confrontation will continue to plague the bilateral relationship, but neither of the two peoples wants to live in the shadow of confrontation or a new Cold War. In this time of globalization and information digitization, confrontation is never the workable solution to problems between big powers. It is predictable that the wrestling between the positive and negative forces on the question of whether and how to build a new type of big power relationship between China and the U.S. will, over a pretty long period of time, remain normal in their bilateral relations.

The second “normal” is the new way top leaders of the two countries conduct their dialogue.

The way the leaders meet and talk mirrors the current state of the two countries’ relations. In their “non-necktie meetings” at Sunnylands, California, and Zhongnanhai, Beijing, President Xi Jinping and President Barack Obama exchanged thoughts candidly while having casual strolls. The relaxed atmosphere made it easy for the leaders to somewhat reveal their inner thoughts and thus acquire a better understanding of each other. Both meetings exceeded the scheduled time, following neither the U.S. practice nor the Chinese way, but rather a mode both sides had agreed upon on the basis of their needs. The meetings yielded scores of positive results, including a Sino-U.S. joint statement on climate change, the mutual granting of 10-year business visas, expedited negotiations on the investment protection agreement, an MOU on mutual trust between the two armies, and the code of conduct on naval and air military encounters.

The third is the “normal” in economic relations.

While “new normals” are seen in both economies, economic ties between the two countries have also witnessed new trends, which have become normal. First, in an unprecedented fashion, the two economies have become mutually reliant, as was shown in the annual \$600 billion worth of bilateral trade and \$100 billion worth of total mutual investment. They have become each other’s indispensable source of growth. Second, trade and investment orientation has reversed. In the past, China exported more commodities to the U.S. than what the U.S. exported to China, while the U.S. investment in China exceeded that of China in the U.S. Today, however, U.S. exports to China have outgrown its imports while China’s investment in the U.S. has grown faster than U.S. investment in China. The trend appears to be continuing. Third, the U.S. and China have become twin engines for global economic growth with their economic policies coordinated and made transparent to the world. The twin-engine mechanism has replaced the past single-engine mode to become a new normal in the global economy.

Fourth, both countries are expected to get accustomed to a new trend in the comparison of their economic statistics. China has shown a momentum by winning more and more “world’s number one” while the U.S. seems to witness more of a decline in economic data. Both sides should refrain from over-interpreting such discrepancies and treat them cool-mindedly. They should resign themselves to the fact that mutual reliance and integrated economies have become a normal affair.

The fourth “normal” is that competition, heightened vigilance against each other, and striving for co-existence and cooperation, will be frequent occurrences between the two sides.

Strategic contention between the two powers is unavoidable in its nature but it also involves artificial factors that can be avoided. Thanks to the farsightedness and wisdom of both countries’ top leaders, strategic contention has not become the main theme in both sides’ top-level decisions. On the other hand, the traditional theory about strategic contention between big powers lurks behind both sides’ mindsets, keeping them alert and defensive against each other’s attacks or challenges.

Currently, neither the U.S. nor China is able to wipe out the other side. China has no intention to challenge the U.S., while the U.S. finds it hard to change China. Therefore, they have no alternatives other than co-existence and cooperation. Top leaders and sensible think tanks in both countries have come to realize that a stable and positive relationship between China and the U.S. is vital to world peace and development, given that the two countries’ involvement and coordination has proven to be indispensable in many global affairs.

The fifth “normal” is the collision and interaction between the two countries in their efforts to control differences.

Collision is normal in international relations. It reflects countries’ efforts to safeguard their national interests. Collision between major powers, especially between China and the U.S., is hard to avoid and once it occurs it will send an influential message across the world. A typical instance is the collision between them at the Shangri La Dialogue, during which the U.S. and its Asian

allies staged a farce of collective battering of China.

Interaction, on the contrary, is an effective way of generating positive energy. The recently released Sino-U.S. Joint Statement on Climate Change was achieved amidst the two countries' collision and interaction. It sends a positive message from the world's two major carbon emitters to the rest of the world on how they will cope with the climate change and guide the UN-hosted inter-governmental talks.

There are a plethora of problems between China and the U.S. that call for control through constructive efforts. They are mainly demonstrated in collisions caused by Washington's attempts to safeguard its hegemonic status and interests against China's effort to protect its sovereignty and safeguard domestic stability.

The Sino-US collision directly or indirectly influences the relations among the world's major powers as well as the two nations' relations with China's neighboring countries. It also has a bearing on the relationship between traditional alliances and new partnerships. The practice of sacrificing the third party's interests for the sake of forming an alliance is old-fashioned. It is advisable to constrain alliance and go for interaction so as to reduce tensions and achieve win-win cooperation.

The sixth "normal" is that the cycle of balance and rebalance will become normal in the Sino-U.S. games in Asia-Pacific.

In the region, there are always hard-line talks with regard to confrontations between major powers. The region needs to establish a proper political, economic and security order for cooperative development. The U.S., however, abused its status as the world's sole superpower to instigate troubles in the region and then play the

role of mediator so as to fish in troubled water. In many cases, Washington plays the dual role of arsonist and firefighter.

The U.S. has always called on China to contribute more to the global economy. However, when Beijing proposed to set up an Asian Infrastructure Investment Bank and start negotiations for establishing the Asia-Pacific Free Trade Area, Washington's attitude turned incomprehensibly ambiguous. Whatever kind of order is to be established in Asia-Pacific, someone has to play the leading role. Washington knows well that it is difficult, and impractical, for it to continue to play such a role solely. Neither Japan nor the ASEAN is able to assume the role. Under the circumstances, it will be a new normal in the region how the U.S. will handle its relations with China and its Asian allies.

For the sake of either Asia-Pacific security or economic cooperation, both the U.S. and China are the region's indispensable mainstays for stability and development. Asia-Pacific is where China has its home for subsistence while the U.S. has major interests in the region. They should put aside their differences, keep strategic contention within a controllable sphere and seek win-win cooperation in the region. This is the area where they should start their experiment for a new-type major country relationship.



Time to Focus on the Larger Picture



Cui Liru

*Former President,
CICIR*

Cui Liru describes a transforming international picture of national power relations, one that is moving toward a multipolar world of influence. In order to avoid the possibilities of true confrontation, China must more clearly realize what it wants to achieve in the world, and also needs to imagine what a peaceful coexistence with the U.S. would look like.

The most critical factor in understanding the current state of the China-U.S. relationship is the ability to see it in the larger picture. In other words, in the 21st-Century international landscape and where it is headed.

The political, economic and security order of the world today is undergoing a rapid shift. International relations have never appeared as fluid as they do today. To some extent, the same can be said about the China-U.S. relationship, which is

very much a part of that larger transformational trend.

This relationship has been an intrinsically complex one from the very beginning and even more so in a time of major change. It presents both opportunities and challenges featuring contradictory trends and competing interests. For many trying hard to peek through the mist into where exactly this relationship stands, the best they can do is to provide a personal perspective, which could be vastly different given the wide perception gaps that exist. People are starting to question even some of the widely shared views about this relationship. It seems that no one is able to describe precisely what the whole picture of China-U.S. relations looks like at the moment. This is not unexpected, because the relationship is going through a transition. The current decade is a morphing period for the world. And the China-U.S. relationship is no exception.

As far as the global political structure or strategic order is concerned, the unipolar international system with the United States at the center is already unraveling, even though it remains the single superpower in the world. But it is anyone's guess now what the future multipolar order would look like. Some say it will turn into a nonpolar world, while others believe with China on track to become a new superpower, a bipolar world is on the horizon.

People tend to believe that since China became the world's second largest economy, the competition between the United States, an established power, and China, a rising power, has grown fierce. But opinion is divided as to where this competition will lead. On the one hand, by definition, a rising power is on the up, whereas

an established power tries to avoid a decline. In this sense, China apparently has more reason for confidence and optimism.

On the other hand, though the United States is relatively on a decline, it is still way ahead of China in terms of strength and influence. As for how long the disparity will last, opinion is again divided. Their duration of influence is determined by not just the two countries' actions at home and abroad in the next one or two decades, but also plenty of other factors beyond their own borders. In a word, the answer to the question remains largely uncertain.

The world is an ever-changing place. The current international system is still dominated by the United States but the nature of the shift from

a U.S.-centric post-Cold War unipolar order to multipolar one is a process of decentralization. Needless to say, despite its structural effect on everyone, the biggest impact of that shift will descend upon the

United States. The shift is, however, generally in China's favor. The United States apparently has a much bigger stake in the unipolar system. For every five to eight units of stakes that China holds in that system, the United States probably holds 20 to 30 or even more, hence the much bigger impact of the structural change on the United States than on the emerging powers. In the same vein, regions suffering from instability and turmoil, partly attributable to the structural change, pose a bigger challenge for the United States too. Though the United States has scaled down its role abroad and "pivoted" to the Asia-Pacific, the Middle East and the situation in Europe have held the Obama Administration back from executing its diplomatic strategy effectively.

***The current decade is a morphing period for the world.
And the China-U.S. relationship is no exception.***

What matters most to the China-U.S. relationship is its overall direction. Throughout the decades since the two sides resumed engagement, this relationship has on the whole been moving in the right direction even though their aims do not always align. Admittedly, there has been friction, tensions and even clashes, but the two countries are neither on a collision course nor moving in opposite directions.

However, with the ongoing tectonic shift in international relations, structural tensions and strategic competition between the two countries are on the rise, raising uncertainty about this relationship. A particular source of concern is the risk of confrontation caused by misjudgment

What matters most to the China-U.S. relationship is its overall direction. Throughout the decades since the two sides resumed engagement, this relationship has on the whole been moving in the right direction even though their aims do not always align.

following unexpected incidents. The possibilities of a head-on collision could thus become very real. As a matter of fact, ongoing debates about the so-called “inevitability of rivalry between a rising power and an established power” or “a new Cold War” all boil down to one question: will there be a fundamental shift in the future direction of China-U.S. relations?

To answer that question, China needs to an-

swer the following questions first: how should it perceive this world? As it grows in strength and forges closer ties with the world, what kind of relations and order does it desire? What does it want to achieve with the United States? What China wants is very much associated with U.S. interests, because China is an integral part of the world. “What China wants” is primarily determined by what the world looks like in China’s eyes. Some argue that China’s goal is to become a major power with global preeminence. Others argue it is better for China to focus on East Asia alone and be content with being the leader of the region — a wise decision from weighing its strength and bearing in mind what happened to empires that came before the United States. There are even those who urge China to be more ambitious and replace the United States. But that creates the question of how exactly can China achieve that. Does China have the capacity? When should that happen? In what way can it happen? I do not think people in China have truly gone through with these questions yet.

Instead of taking over the U.S. position in the world, China can also choose to live in peace with the United States. Ideally, the gap between the two countries will gradually shrink and eventually they will get along with each other in a multipolar world. But before we ever reach that day, we still need to ask ourselves: what exactly does “living in peace with the United States” mean for us? What is the clearest pathway toward that end? Can China and the United States live together in peace in Asia? As big as these questions may be, they hold the key to keeping the China-U.S. relationship on the right track into the future. This is the larger picture, which actually explains why the Chinese side put forward the concept of “a new model of major-country relationship.”

Chinese Enthusiasm and American Cynicism: The “New Type of Great Power Relations”



*Cheng Li and
Lucy Xu*

Brookings Institution

The “New Type of Great Power Relations” enables China to establish a code of conduct to protect its core interests, but the U.S. has not completely adopted it out of protection of its own geopolitical allies. For greater endorsement China should advance the interests of smaller nations in the Asia-Pacific, and the U.S. should move beyond its Cold War, realist mentality.

As China-watchers were quick to point out, President Barack Obama did not even once mention the “New Type of Great Power Relations” on his recent trip to Beijing.

It has been widely noted that President Xi Jinping, however, repeatedly promoted the framework first at the U.S.-China Strategic and Economic Dialogue (S&ED) in July, and then at the summit with Obama in mid-November. After the summit, China’s official news agency reported that Xi and Obama “pledged to push forward a new type of major-country relations,” and that “[Obama] is willing to... lift the new type of major-country relationship between China and the U.S. to a higher level.” Xinhua implied that Obama not only accepts, but also actively supports, the “new type” concept. In fact, the Obama administration has been cautiously staying away from it.

Why is China so keen on a “New Type of Great Power Relations” and on creating perceptions of endorsement by Obama? And why is the U.S. reluctant to adopt it? What are the reasons behind such contrasting views -- Chinese enthusiasm and American cynicism -- towards this seemingly benign concept?

When Xi Jinping defined the “New Type of Great Power Relations” in his meeting with Obama at Sunnylands last year, he described it in three points: 1) no conflict or confrontation, through emphasizing dialogue and treating each other’s strategic intentions objectively; 2) mutual respect, including for each other’s core interests and major concerns; and 3) mutually beneficial cooperation, by abandoning the zero-sum game mentality and advancing areas of mutual interest.

Embedded in the “New Type of Great Power Relations” is a nation’s hope for an international environment more conducive to its development. From the rise and fall of its many dynasties to its forced opening up to the West in the wake of the Opium Wars, China has always seen itself as a civilization deeply entangled and affected by history. Recognizing the historically recurring clashes between an existing great power and an emerging power, China looks to the “new type” framework to avoid historical determinism and to seek a less-disruptive rise in an increasingly integrated world.

At the same time, China wants to be viewed as an equal. By using the term “Great Power” to primarily, if not solely, refer to China and the United States, China aims to elevate itself to a level playing field. Obtaining U.S. support of the concept would imply Uncle Sam’s recognition of China’s strength and power. This is what China’s official media sought to show when it suggested Obama’s support of the concept: parity and respect between the two countries.

Furthermore, Chinese leaders believe that the “New Type of Great Power Relations” enables the two powers to establish a new code of conduct in line with China’s interests. By emphasizing the respect of “core interests” as an element of the concept, China pushes its territorial claims to the forefront. This is China’s attempt at more clearly demarking where the United States and other neighboring countries need to toe the line. American adoption of the term would imply that the United States recognizes China’s “core interests.” This mutual respect of each

other’s national interests is at the core of China’s aspirations.

The Chinese media avidly reporting on Obama and Xi’s joint endorsement of the concept suggests that there are also domestic reasons driving the “New Type of Great Power Relations.” Although the Chinese concept is an inherently U.S.-geared proposal, the domestic goals of such a concept should not be overlooked. From a Chinese perspective, the United States is the only superpower in today’s world that has the capacity to contain China’s rise.

By strengthening China’s view of itself as a recognized and respected power, Xi Jinping is able to foster stronger nationalistic pride under CCP leadership and gain political capital to consolidate his own power at home.

Across the Pacific, Americans view this Chinese concept with suspicion and cynicism. The United

States is particularly sensitive to how its adoption of the concept would be portrayed by allies in the region.

Traditionally, American policy makers have no interest in embracing a new geopolitical framework offered by another country. There are unspoken concerns that American recognition of the Chinese concept would not only imply that Obama is taking a backseat role in the bilateral relationship, but also suggest that the United States recognizes itself as the declining established power in a “Thucydides trap” with rising China.

However, the key barrier for the White House is its suspicions towards Chinese intentions. Wash-

***Xi Jinping defined the
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ington is not fond of Chinese designs to obtain foreign recognition of its “core interests,” which the administration sees as a murky jumble of territorial demands. Cynics see it as China’s “trap” to gain official American recognition of its disputed territorial claims in the East China Sea and the South China Sea.

Moreover, the Pacific power is held back by how neighboring countries in the region would interpret its embracement of the concept. The “Great Powers” framework is inherently flawed, as it ignores key American allies and the important role they play for the United States in the region. From a Japanese perspective, a stronger U.S.-China relationship threatens their security alliance and exacerbates fears of abandonment. Other smaller countries such as the Philippines and Vietnam worry that the stronger partnership would only fuel Chinese expansionism. With such concerns from pivotal allies, the United States is reluctant to risk upsetting the regional security balance.

How can Beijing and Washington reconcile their differing attitudes towards the “New Type of Great Power Relations”? If China seeks American endorsement of the concept, it needs to adopt real changes in its behavior to demonstrate commitment and resolve towards the stability and prosperity of the region. China needs to develop a keener sensitivity to how its actions are perceived. Greater assertiveness in territorial disputes and a hardened stance against its neighbors do no good to improve China’s image. The emerging power needs to take on the responsibility to be a voice for smaller Asian countries and to advance the interests of the Asia-Pacific region. The concept will not succeed if it is not

backed by substantive action.

On the other hand, the U.S. should also re-evaluate its position on the “New Type of Great Power Relations.” The concept has helped to break old mindsets, challenge realist thinking and erase a cold war mentality. As Larry Summers once said, he could picture a 21st Century in which the United States and China both prospered, or a 21st Century in which both countries failed to prosper, but not one in which one country prospered and the other did not. The Chinese concept evidently has similarities to the worldview of American leaders and scholars such as Summers, and no country should

or can monopolize the ownership of this common worldview. Thus, the Obama administration should not be too cynical about it. A better American strategy could be developed. Instead of being overly concerned with the specifics, the United States should look at the bigger

picture: the concept is constructive and helpful so long as it can effectively guide and encourage a non-confrontational foreign policy in China.

***The concept has helped
to break old mind-
sets, challenge realist
thinking and erase a
Cold War mentality.***

Is China Trying to Drive the U.S. out of Asia?



Wu Zurong
*Research Fellow,
China Founda-
tion for Int'l
Studies*

Internal causes in China are the basis of changes and developments in Asia, while external causes, such as relations with the other parts of the world, are secondary, and become operative through internal causes in Asia. Through this logic, Wu Zurong argues that the U.S. should consider its own development path before concerning itself with lost influence in Asia.

Some American scholars and observers are growing more worried about the “U.S. being driven out of Asia.” Their reason for such an assessment is that China is exerting more influence in economic policy, trade, investment, and security in Asia and that it is working more closely with certain U.S. allies in Asia for its own benefit.

These pundits are making entirely incorrect judgments because of their lack of knowledge of Chinese culture. In particular, they must have missed the statements made by Chinese President Xi Jinping on May 21, 2014, at the Fourth Summit of the Conference on Interaction and Confidence Building Measures in Asia (CICA). President Xi said, “In the final analysis, things in Asia are done by relying on the Asian people, problems in Asia are resolved by relying on the Asian people, and security in Asia is safeguarded by relying on the Asian people.”

Without understanding the essence of President Xi’s statements and the traditional Chinese philosophical tradition, they jumped to the conclusion that China intends to exclude the U.S. in Asian affairs or simply attempt, in the long run, to gradually drive the U.S. out of Asia.

Actually, by applying the theory of material-

ist dialectics to the analysis of the situation and diplomacy of the world, and of Asia in particular, President Xi is expounding his views on the fundamental cause of developments and changes in Asia. Internal causes in Asia are fundamental, and also the basis of changes and developments in Asia, while external causes, such as interrelations and interactions with the other parts of the world, such the U.S., Europe or Russia are secondary, and they become operative through internal causes in Asia. In Asia’s relations with other parts of the world, there is simply no such a question as exclusion of the U.S., or other countries and regions. In the philosophical Chinese perspective, the U.S., Europe, Russia or any other parts of the world cannot do things, or resolved problems, or safeguard security in Asia on behalf of the Asian people, for their interrelations and interactions with Asia are secondary in terms of causes of changes and developments in Asia.

U.S. scholars and observers will certainly find no problems when people say that in the final analysis, things in the U.S. are done by relying on the American people and problems in the U.S. are resolved by relying on the American people. In fact, the principle applied to the analysis of changes and developments in the U.S. is the same as that applied to the analysis of



U.S. President Barack Obama, left, and Chinese President Xi Jinping shake hands following the conclusion of their joint news conference at the Great Hall of the People in Beijing, Wednesday, Nov. 12, 2014. (AP Photo/Pablo Martinez Monsivais)

changes and developments in Asia. Why do U.S. scholars and observers have two entirely different perceptions of the application of the same principle? Their deep-rooted concept of the U.S. relations with the other parts of the world is an important reason, in addition to their lack of knowledge of the prevailing philosophical theories in China.

As the U.S. has been the only superpower in the world for the last several decades, quite a number of U.S. political leaders and scholars have held the notion that the U.S. has been playing a “leadership” role in the world and is of course “leading” Asia, Europe, Africa, Latin America and other parts of the world. Therefore, they generally cannot understand why the U.S. role in Asia, Europe, or other parts of the world is defined as “external cause of changes and developments” in Asia, Europe, or other parts of the world, and why its role becomes operative through internal causes there. It is a real example in our daily life that such a cul-

tural gap in people’s concept and knowledge could lead to misjudgment of each other’s strategic intentions. When such misjudgment is exaggerated through repeated media reports, it could harm mutual political trust, or even in certain cases, disrupt the normal decision-making process, causing artificial troubles for the relationship between the U.S., and other parts of the world.

China and the U.S. are working hard together to establish a new type of major power relations, and have made visible progress in recent years.

To continue the process of positive interactions between China and the U.S. in world

affairs, and especially in Asia, the two countries will find it important, even imperative to further deepen mutual understanding in areas of culture and social science. It is a simple fact that the U.S. has long been playing a role in Asia, and that China welcomes and encourages the U.S. to continue its constructive role in Asia, both at strategic level and in specific multilateral programs, such as the Asia Infrastructure Investment Bank, Silk Road Fund and others.

But the difficult problem is that such simple facts could be denied or misunderstood through lack of knowledge of the cultural or social traditions of the other country. How to understand the differences in culture and social science between China and the U.S., and how to make further efforts to narrow those differences so as to avoid any possible misjudgment of the other side should be urgently brought to the attention of the academic circles and government departments concerned of the two countries.



Obama Speech Reaffirms Security Policies with China by Omission



Richard Weitz
*Senior Fellow,
Hudson Institute*

By not emphasizing security differences with Beijing, President Barack Obama's State-of-the-Union address made evident his general satisfaction with the success of his China policies.

By not highlighting U.S. security disagreements with Beijing in the same way that he addressed Washington's differences with Moscow in his January 20 State of the Union address, U.S. President Barack Obama communicated by omission his belief that U.S. security relations with China are proceeding satisfactory, at least in general. In this sense, he reflects the general American belief that relations with China are

a manageable admixture of cooperation and competition.

As noted in the Chinese media and elsewhere, Obama's most explicit mention of China came in a warning to Congress to back his trade policies in East Asia: he declared that U.S. businesses "need to sell more American products overseas ... But as we speak, China wants to write

the rules for the world's fastest-growing region. That would put our workers and businesses at a disadvantage." However, the United States does not need to stand by and watch this happen, but instead "we should write those rules" by giving him more trade promotion authority and other support for his Trans-Pacific Partnership, which would at least initially exclude China.

In earlier State of the Union speeches, Obama used a similar tactic of trying to secure congressional backing for his domestic policies—such as more federal funding for education and infrastructure—by citing the need to match the Chinese government's large investment in these areas. His reference in last week's speech to encouraging the return of manufacturing jobs from China to the United States through freer trade was a defense of his economic policies rather than an attack on China.

Conversely, Obama's boasting of his "historic" November 2014 deal with Beijing to cut carbon emissions by the end of next decade was an example of the mutual advantages that are attainable when Beijing embraces U.S.-supported global norms. The President has emphasized elsewhere that the United States needs China's cooperation to pursue its international agenda since on many important issues Washington cannot achieve its goals by itself.

Time limits and the need for audience attention were likely the only reasons that Obama refrained from noting how China and the United States could collaborate to prevent nuclear proliferation, fight terrorism, bring peace to Afghanistan, or, as pointed out in an earlier article by Dong Chunling and Sun Chenghao of the China Institutes of Contemporary International Relations, jointly address Ebola and other health emergencies.

A January 22 Huanqiu article claimed that Obama had an "hegemonic attitude" in presum-

ing that it was a U.S. responsibility to "lead the world", but such U.S. global leadership has been demanded by many of the world's governments, including China. Indeed, in Beijing last December I frequently heard the complaint that the United States was failing to provide adequate global goods such as security and free trade, to the detriment of all countries. And in his speech Obama still stuck to his "lead from behind" rhetoric in emphasizing several times how his administration shunned unilateralism and strived to work through coalitions in defense of collective security.

Obama was softer on China this year than in some of his earlier speeches. He avoided explicitly mentioning such sources of tension as alleged Chinese cyber stealing of U.S. commercial and military secrets, the growing U.S. security ties with Japan and India, American concerns about Beijing's assertive maritime territorial claims, China's close ties with Iran and North Korea, and even the president's misunderstood Asia Pivot, which many in Beijing mistakenly see as designed to contain China's rise. However, Obama's observation that, "in the Asia-Pacific, we are modernizing alliances while making sure that other nations play by the rules in how they trade, how they resolve maritime disputes, [and] how they participate in meeting common international challenges like nonproliferation and disaster relief," applies at least indirectly to China.

Restructuring U.S. security ties with Japan, South Korea, the Philippines, and Australia has been a core tenet of the Asia Pivot from the beginning. Initially, this overhaul mainly involved basing and other traditional military issues, but recently the focus of alliance restructuring has expanded to encompass more joint action on disaster relief, cyber security, and other transnational threats. For example, Washington has encouraged Tokyo to reinterpret Japan's constitution and thereby increase the ability of the

Japanese Self-Defense Forces to participate in regional security missions, though Japan still cannot even consider launching a hostage rescue attempt in distant Iraq.

Furthermore, Obama's references to maritime disputes were directed at the low-level conflicts in the South China Sea, while his calls for upholding nonproliferation and humanitarian norms could apply to Beijing's reluctance to press Tehran and Pyongyang harder on its nuclear and human rights policies.

Many members of Congress would likely agree on the importance of these goals, though they would differ on the effectiveness of U.S. policies in securing Chinese support for the initiatives. Obama could credibly cite progress regarding each objective in the last few years while critics could justifiably point to continuing gaps between U.S. objectives and Chinese policies.

That said, the focus of Obama's State of the Union speech was on U.S. domestic affairs, particularly the recovery of the American economy, and short discourse on foreign affairs concentrated on the Middle East. Furthermore, unlike in his discussion of trade, there was no explicit call to action in his security references directed at Congress. Obama likewise avoided trumpeting a "China threat" as a prop to rally the members behind more defense spending or the passage of long-stalled cyber security legislation.



President Barack Obama delivers the State of the Union address in the House Chamber at the U.S. Capitol in Washington, D.C., Jan. 20, 2015. (Official White House Photo by Pete Souza)

What is “New Normal” of China’s Economy?



Yu Yongding
*Former President,
China Society of
World Economics*

Over the past two decades, China’s growth paradigm characterized by investment and driven by exports has run out of steam. A major feature of China’s current economy is overcapacity, especially in the real estate sector. An increase in domestic consumption and infrastructure investment will help continue growth, but the biggest challenge facing China in 2015 is the high corporate debt ratio.

To the disappointment of those China observers, who bet on a coming collapse of the Chinese economy, the year of 2014 for China was rather uneventful. The real estate market didn’t crash and there were no major defaults of shadow banks. Local government debts are still under control. Overcapacity? Yes, but it failed to drag the economy into a hard landing. At this point in time, it should be a bygone conclusion that China will achieve a growth rate not far apart

from 7.5 percent, the target set by the government for 2014.

What is predicted for the Chinese economy in 2015? Until 2012, most Chinese economists still hoped that the economy would rebound strongly and return to the growth trajectory they had become accustomed to. Now, they have given up such hope. Instead, they believe that the economy has entered a new stage, in which a

China's GDP Growth Rates from 2004-2014



Sources from: China NBS

significant lower growth rate will last for a relatively long period of time. This is the so-called “New Normal,” which is characterized by three changes.

First, the high growth of the Chinese economy has become a thing of the past. For a quite long period of time in the future, growth of the economy will be hovering around an unimpressive rate of 7 percent or lower. Second, the government will avoid using expansionary fiscal and monetary policy to stimulate growth as long as the growth rate has yet to hit an unspecified bottom line—7 percent probably, even if there is still ammunition left in the government arsenal. Third, further market-orientated reforms will be implemented in a firmer manner even at the expense of growth—up to a limit. The just wrapped-up central economic work conference, which is the most important annual conference on economic affairs each year, seemed to have endorsed this view.

First, the high growth of the Chinese economy has become a thing of the past.

Overcapacity is the key feature of the economy in 2014. When an economy is suffering from overcapacity, the traditional countermeasure is straightforward: using expansionary fiscal and monetary policy to stimulate aggregate demand. However, China's current overcapacity is structural rather than cyclical. Its growth paradigm over the past two decades characterized by investment and driven by exports has run out of steam.

China's investment roughly consists of three main components: manufacturing investment, real estate investment and infrastructure investment, which, according to Morgan Stanley, account for 34 percent, 23

percent and 18 percent of fixed asset investment, respectively, in 2013.[1] Since 1998, as the single most important driver for growth, China's real estate investment has maintained a growth rate of more than 20 percent, more than double of that of GDP growth.

After two decades' investment-mania in real estate, China simply has built too many luxury five-star hotels, ugly skyscrapers, empty shopping malls, imposing government office buildings, and high-end condominiums. As a country with per capita income of \$6,700, China's home ownership has surpassed 80 percent, dwarfing the U.S.'s 65 percent, let alone Germany's 40 percent. This is a massive misallocation of resources.

The government is worried about real estate bubbles and the growing resentment towards

skyrocketing house prices among ordinary people, especially those dwellers of municipal cities. According to a recent study, more than 1 in 5 homes in Chinese cities are empty.[2] However, at the same time, for a young couple in Shanghai, they have to work for 24 years without spending a single penny to save enough money to buy a moderate flat. In response, the government tries to adjust the structure of house

supply and clamp down on house prices at the same time. For the former, it is easily said than done. As a result of the latter, growth of real estate investment has fallen to 12.6 percent up to October in 2014. Now even the most bullish real estate developers have changed their views and admitted that real estate investment is likely to fall further in 2015.

The slowdown of real estate investment not only has hit growth directly but also dragged down the economy via its impact on manufacturing investment. The government has mistakenly targeted real estate development as the pillar of the economy since early 2000s. A very large

proportion of economic activities are subject to the need of real estate development. The steel industry is a case in point. China has built thousands of steel mills with production capacity of 1 billion tons, which accounts for half of the global total. With the slowing down of real estate development, the bulk of steel mills immediately went under. In 2013, profit of two-ton steel was just enough to buy a lollypop. In 2014, the situation will not change much. The same is true of many other industries in the manufacturing sector.

Second, the government will avoid using expansionary fiscal and monetary policy to stimulate growth as long as the growth rate has yet to hit an unspecified bottom line—7 percent probably.

Then, how about export and consumption? Export has been a drag on growth for years. China has already been the world's largest export nation. The world is too small for China's export drive. China's exports are competitive, but not invincible.

Are there any components of aggregate demand in China that can increase fast enough to offset the negative impact of the fall in real estate investment and

export growth on growth of the economy? In recent years, household consumption has tended to increase, while having some ups and downs. However, due to its relatively small share in the economy and consumer inertia, consumption growth cannot suddenly become the engine of growth.

Perhaps, the only straw is infrastructure investment. In fact, China has planned to build more railways and highways. The so-called silk-road strategy certainly can help China to cushion a hard landing, though it is also likely that this new endeavor will cause new problems for the economy. Besides this grand project, China's

air is chocking and poisoning water; it is aging quickly; its medical services are pathetic. China has to make up the deficiency in investment in these areas. Nevertheless, to do so, China has to put adequate incentive in place first, and, due to the limits of absorption capacity and funding difficulties, public investment has to increase in a gradual fashion. Rome was not built in one day. You can build many hospitals in one year, but you cannot train qualified doctors and nurses in a short period of time.

As a result the high growth rates of investment and export over the past decades, China's share of investment in GDP has approached 50 percent of GDP, by far the highest in the world, and its share of export in GDP is also the highest among the large economies. Even if China still has the fiscal

and financial ability to speed up investment and export growth, it should refrain to do so. Otherwise, overcapacity will get worse in the future.

What China needs to do is to shift the growth paradigm from demand-led to innovation-based. Only when the growth is based on innovation and creation, can supply automatically lead to demand and the Chinese-style overcapacity be overcome. However, this is no longer simply an economic issue and the change will take time. Even if China can embark on such adjustment, some long-term unfavorable factors such as aging will creep in and create large uncertainty for China's economic future.

In short, on the one hand, due to the overcapacity, the Chinese economy will continue to slow down; on the other hand, growth in infrastructure investment and household consumption can partially fill in the demand deficiency left by

the fall in growth of real estate investment. As a result, the Chinese economy should be able to obtain a growth rate of 7 percent in 2015.

China's financial situation in 2015 is more precarious. The specter of a financial crisis will continue to loom over the economy. However, it is difficult to judge whether, when, and how a financial crisis will be triggered in China. There are many potential triggers. Among them are a

real estate bubble, shadow-bank activities, defaults of local government finance vehicles (LGFV), and capital flight. Whatever the trigger is, the fundamental cause of the financial crisis is, almost without exception, attributable to the unsustainability of debts. China's total debt-to-GDP ratio has surpassed 250. Its corporate debt-to-GDP ratio is around 120 to 150

percent, by far the highest in the world. Fortunately, on top of its very strong external position, China's household debt-to-GDP ratio is low and its public debt on the whole is still in a good shape. In my view, the biggest challenge facing China in 2015 and beyond is the high corporate debt ratio compounded by the slowdown of the economy.

All in all, 2015 will be a very challenging year for China. However, no one should forget China's extraordinary ability to muddle through challenges and keep the economy going. To bet on the coming collapse of the Chinese economy is a very dangerous business. China observers should have learned this lesson.

Third, further market-orientated reforms will be implemented in a firmer manner even at the expense of growth—up to a limit.

[1] <http://www.forbeschina.com/column/ZhuHaibin>

[2] <http://www.wsj.com/articles/more-than-1-in-5-homes-in-chinese-cities-are-empty-survey-says-1402484499>

Asian Infrastructure Investment Bank's First Loan



Stewart Taggart
*Founder & Principal,
Grenatec*

Stewart Taggart makes a case for the Asian Infrastructure Investment Bank's first investment to be in the creation of a Pan-Asian Gas Pipeline to promote the joint development of the South China Sea between China and its South East neighbors, and help achieve their bilateral energy reduction.

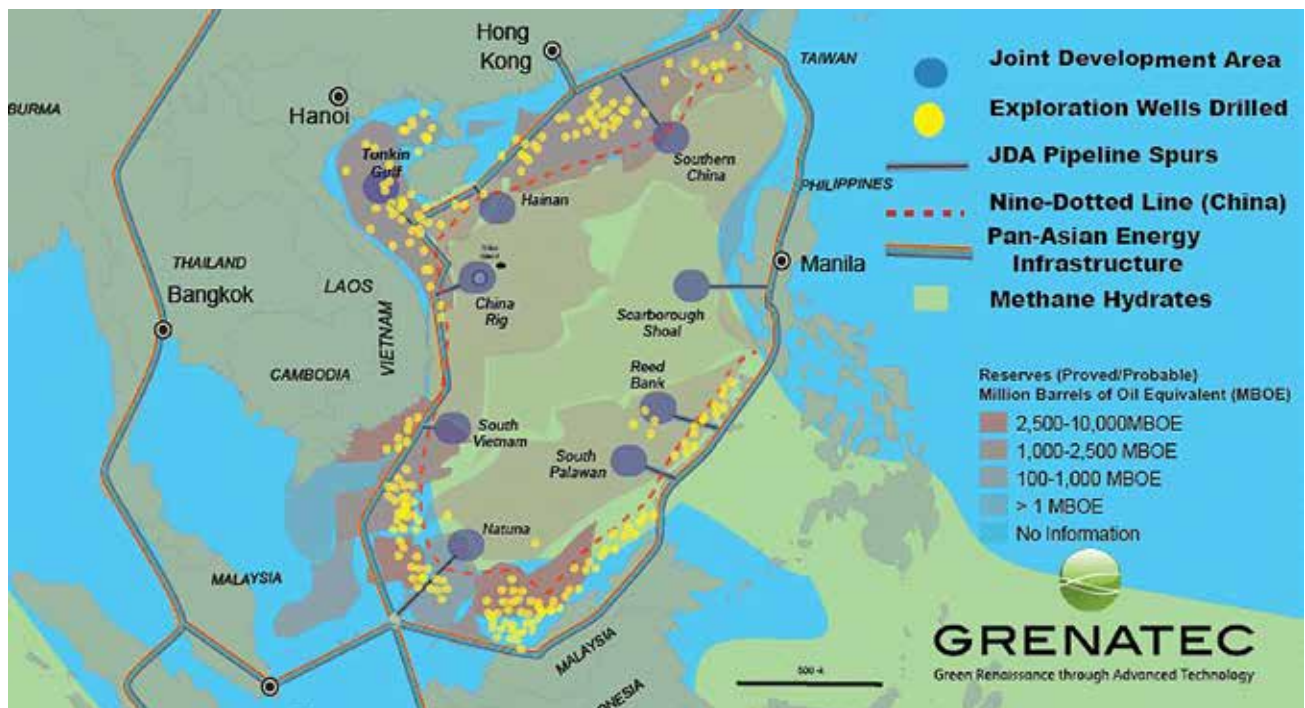


China's Asian Infrastructure Investment Bank's smartest first loan would be for a Pan-Asian Gas Pipeline connecting Joint Development Areas in the South China Sea.

China's Asian Infrastructure Investment Bank will make its first loan this year. Nothing would have a greater impact than bankrolling a Pan-Asian Gas Pipeline.

A Pan-Asian Gas Pipeline could connect a series of Joint Development Areas in the South China Sea. These areas would develop the region's offshore oil, gas, and methane hydrate resources. However, the development of this region is still being held up by territorial uncertainties created by China's Nine-Dotted Line.

Funding a Pan-Asian Gas Pipeline serving Joint Development Areas represents the most powerful signal China could send of its commitment to regional multilateralism. Markets would do the rest and the timing couldn't be better. China and the U.S. recently agreed to binding targets for reducing carbon emissions. Moreover, this coming December is the Paris COP21 climate change negotiations, which are globally transformational as the participating nations must agree to binding



global carbon cuts.

To date, South China Sea oil and gas exploration and drilling has been largely limited to near shore areas due to uncertainty over China's maritime claims. Large potential oil and gas deposits still remain unexplored. This is economically inefficient.

A Pan-Asian Gas Pipeline linking Joint Development Areas solves this problem. It marks a first step toward creating an integrated regional energy market. Together with carbon prices, it would be the most powerful tool possible for reorienting the Asian economy to low emission energy using markets, energy fundability and universal access.

Asia is now the world's largest economic bloc. Reducing destructive climate change largely hinges upon Asia and the energy choices it

makes in coming decades. A gas pipeline increases economic growth through expanded energy trade — a massive double win. Both the International Energy Agency and the Asian Development Bank both repeatedly stress the importance to the global economy of deeper Asia energy market integration.

A Pan-Asian Gas Pipeline connecting Joint Development Areas allocated by auction binds China into a universally-beneficial multilateral order. Funded by China's AIIB with its neighbors as partners, it would represent a regional economic Marshall Plan which could eliminate the major irritations related to China's expansive territorial claims with its neighbors.

Asia needs trillions of dollars for new infrastructure investment. Half total of this is for energy alone. A number of proto-Pan Asian Gas Pipeline proposals already exist, including the Association of Southeast Asian Nations' (ASE-

AN) Trans-ASEAN Gas Pipeline concept. All gas pipeline proposals have the same aim: delivering South China Sea natural gas to Chinese markets.

Given that ASEAN members now comprise half the AIIB's membership, funding a first project in the ASEAN region is a logical outcome of the AIIB's creation. It would represent just the first step toward creating a larger regional energy network topology to deliver a broader array of future fuels. That's because a properly constructed gas pipeline can carry natural gas initially and methane hydrates, bio-energy, hydrogen over the long term. Liquid Natural Gas infrastructure can't do this. This creates huge, presently undiscounted obsolescence risk to LNG investments in Asia, most demonstrably in Australia's Queensland.

Pathways laid down by natural gas pipelines enable other infrastructure (such as fiber optic cables and High-Voltage Direct Current power lines) to be added later. Power lines, for instance, can enable offshore wind, wave energy and ocean thermal energy to be developed and delivered. Single-purpose LNG pipelines can't do this.

The potential for such multi-purpose South China Sea energy infrastructure is readily apparent in ASEAN's proposed Trans ASEAN Electricity Grid — a companion project to the Trans-ASEAN Gas Pipeline. Laying the foundations for a regional HVDC infrastructure to a regional gas infrastructure could be the AIIB's second investment.

Offshore energy infrastructure in the South China Sea could become an important source of food for a rising income region. Offshore infrastructure becomes fish aggregation devices. Aquaculture can take root there, providing protein to a hungry region.

With all countries working together toward a common goal, the role of military forces can change from preparing for conflict to ensuring infrastructure security and engaging in humanitarian activities, like providing emergency relief from typhoons, tropical storms and earthquake induced tsunamis. Cooperative militaries also could provide security for the infrastructure.

As at only a few times in history before now — the timing is perfect for this kind of big 'step change.' China's Asian Infrastructure Investment Bank is coming at the very time that the U.S. and China now see eye to eye on reducing bilateral carbon emissions and COP21 meets in Paris.

China Expands Infrastructure Projects in Latin America

Walker Rowe

Publisher, Southern Pacific Review

Chinese companies and banks are building and funding many infrastructure projects across Latin America. Analysts have said some of these projects are being built for geopolitical reasons, but the main reason is to secure supplies of natural resources for the burgeoning Chinese economy.

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A Railway to Connect two Oceans

El Economista reported in November that Brazil, China, and Peru signed a memorandum of understanding during the Asia-Pacific Economic Cooperation Forum that they will jointly build a railway that will connect the Pacific Ocean to the Atlantic – a great distance of 3,500 km. This is a heavy lift as there is not even a major highway running across the continent. In places, mud, snow, and jungle make the journey quite difficult.

The newspaper reported that this was the first step in a \$10 billion project that “will facilitate the export of raw materials.”

The train will help exporters avoid the cost of

passing through the Panama Canal, as the tariff for doing that has increased in recent years. (In August, we wrote about Chinese plans to build a \$40 billion canal across Nicaragua here, to compete with the Panama Canal. The only update to that news is that the Chinese contractor this month reiterated its plans to start construction in December.)

El Economista said, “...in the last three decades Beijing has increased its contacts to finance and building infrastructure in exchange for access to petroleum and minerals.” You could add to that list of raw materials soybeans, since Brazil exports huge quantities of those, plus corn. Both Brazil and Peru have petroleum and natural gas. Brazil also has iron ore. Peru has much copper, gold, silver, and iron ore.

Regarding another rail project, Reuters reported in June that the China Development Bank loaned Argentina \$2.1 billion to build a rail project that “would make it more efficient to transport grains from Argentina’s agricultural plains to its ports.” Argentina is the No. 3 exporter of soybeans and corn in the world.

Mexico City High Speed Rail Project On Hold

China Railway will have to bid again on a project to build a \$3.7 billion, 210 km high-speed rail between Mexico City and Querétaro. The Mexican government awarded the project in November then promptly canceled it when senators said the bidding process was not open. *China Railway*, with a consortium of four Mexican companies, was the only bidder. Siemens and Bombardier expressed interest, but placed no bid.

The Chinese were not happy that the bid was abruptly canceled. The Communist Party-owned newspaper *Global Times* wrote, "Many people's first thought was: Is Mexico joking?" The bidding will be opened again in November, except this time the government will shorten the evaluation period to a short six months.

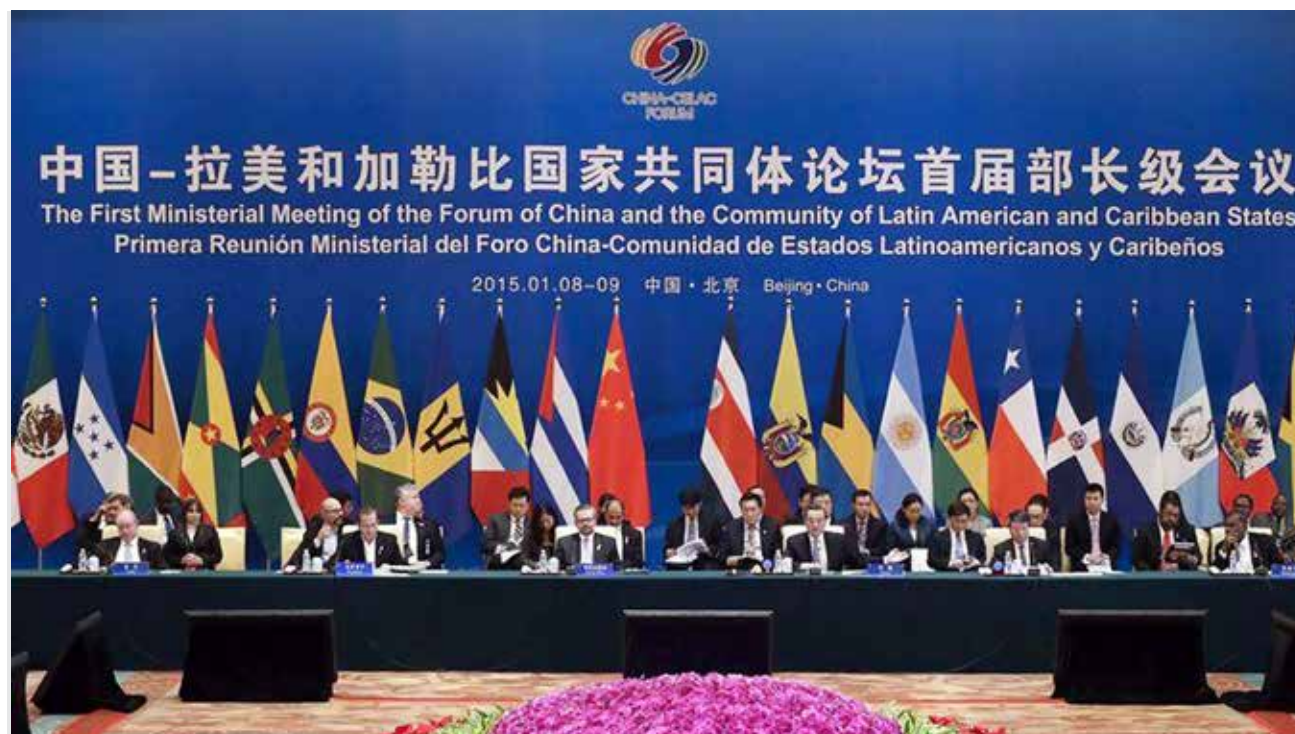
China has built 7,000 miles of high-speed rail in its own country. There is no high-speed rail at all anywhere in North America, including the U.S., where a much-criticized pilot project to build high speed rail into the empty California desert was canceled.

The Mexico City project would have been financed by the China Export Import Bank.

Dams for Hydroelectric Power

China Daily says, "Latin America, with its vast array of powerful and beautiful rivers, may be a relatively recent new frontier for Chinese dam builders, but they are coming on strong now, not only providing hydroelectric power and water for irrigation, but also expanding China's geopolitical clout."

Chinese contractors have 22 hydropower pro-



The First Ministerial Meeting of the Forum of China and the Community of Latin American and Caribbean States (China-CELAC) was held at the Diaoyutai Guesthouse in Beijing, January 8, 2015. (Xinhua Photo)

jects in total in Latin America either underway, already completed, or in the planning phases. These projects are located in Belize, Ecuador, Costa Rica, Honduras, Perú, and Argentina.

Peter Bosshard, policy director for International River, told the *South China Morning Post* that, “There is often a bit of geopolitics involved in these projects. Obviously, Brazil has a very active dam-building industry as well and is kind of the regional powerhouse. But there are governments that are trying to become a bit more independent from Brazilian influence, so that is where China plays a more active role in Ecuador.”

It is interesting to note that there are no Chinese hydro projects underway in Chile, where the high price of and lack of electricity is an issue. There, mining companies have taken to financing hydroelectric, solar, and other projects themselves, often for their own use, as the government has stumbled in its efforts to put together a strategic energy plan.

The Chinese dam constructions projects have been financed by the China Development Bank, the China Export Import Bank, and even the Canadian International Development Agency.

Investments in Mining

BN Americas says that China backs a quarter of Peru’s mining investments. Peru is mineral-rich with copper, gold, silver and iron ore. The website says that Shougang steel is investing \$1.2 billion at its Marcona iron ore mine. Chinalco recently completed a \$3.5 billion expansion at Toromocho copper mine.

In Bolivia, the Chinese are helping Bolivians not just dig lithium out of the ground but turn it into a value-added product: batteries. The LinYi Cake Trade Co. plant is located next to the Uyuni salt flats, by far the largest salt flats in the world,

which is where lithium is found. Lithium batteries power cell phones, tablets, and electric cars. Most of the world’s lithium comes from Chile and Bolivia.

Economía Bolivia reports that the Chinese firm has refitted the rusting remains of a metallurgy plant that had been there before, so it is not quite suited for making a large number of batteries. Bolivian engineers working there characterized the project as more of a training effort for the Chinese company to teach the 19 Bolivian engineers working there how to make lithium batteries. This is to prepare them when the Chinese company ultimately builds a proper manufacturing facility.

In what people working in undeveloped nations sometimes characterize as “bring your own infrastructure,” the Chinese brought everything needed to build the plant, since none of that was available in Bolivia.

The Bolivian project is not a large investment, but at \$2.9 million is still economically significant in the poor high desert of Bolivia – and anywhere in South America, in fact, where raw materials are mined but not refined into something more valuable. There is not much manufacturing at all in any of the companies west of the Andes Mountains.

Finally, after calling the Chinese some of the best bridge builders in the world, the government of Chile award a \$750 million contract to a consortium of companies led by South Korea to build a bridge to Chiloé. Some 150,000 people live on this island in Patagonia, half of them working for salmon farming companies. The 2.7 km bridge will replace the only means to get to the island currently, which is by ferry, thus ending the people’s geographic isolation.

Strong China ODI Momentum Set to Continue in 2015



*He Weiwen,
Co-director, China-US/EU Study
Center, CAIT*

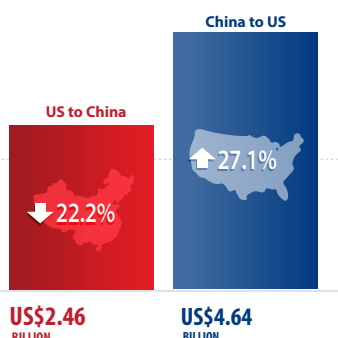
He Weiwen details the monetary values of China's relentless wave of foreign direct investment worldwide during 2014. China's structural changes in its economy, which will allow for further growth in 2015, especially between U.S. and Chinese companies, are also discussed.

The year 2014 witnessed a relentless wave of Chinese direct investment worldwide. The China Group headed by Minmetals Resources Inc., acquired Las Bambas Copper Mine of Peru for \$5.85 billion. China State Grid acquired a 35 percent share of Italian Energy Networks Co. for €2.1 billion (euros). Lenovo acquired IBM X 86 service provider for \$2.3 billion. ICBC purchased a 60 percent share of South African Standard Bank for \$765 million.

According to data from the Ministry of Commerce of China, (MOFCOM) total non-financial outbound direct investment (ODI) volume hit \$89.8 billion during the first 11 months of 2014, up 11.9 percent over the previous year. If this tempo had continued in December, the whole year non-financial ODI would have broken the \$100 billion mark, and total ODI might have hit \$120 billion. In contrast, foreign direct investment into the country has barely kept a positive growth, with only a 0.7 percent year-on-year increase during the first 11 months, reaching \$106.2 billion (non-financial). However, it looks less likely that China could have become a net capital exporting country in 2014, a historical landmark which might be realized in 2015.

Chinese ODI in the U.S. is Rising Fast

Outbound Direct Investment



US\$4.64 billion

US\$ 4.64 billion flew into the US, 27.1% up a year ago, almost twice as large as the US direct investment in China (US\$ 2.46 billion, down 22.2%).

Source :MOFCOM

The scenario of Chinese ODI has changed completely from just a few years ago when roughly 75 percent of its total volume went to Hong Kong, British Virgin Islands and Cayman Islands, while only 10 to 12 percent went to developed economies. Investments in big projects in the US and EU are rising fabulously. According to MOFCOM, \$4.64 billion flew into the U.S., up 27.1 percent from a year ago, almost twice as large as the U.S. direct investment in China (\$2.46 billion, down 22.2 percent). Data from Rhodium Group, a New York-based think tank tracking Chinese direct investment in the U.S., shows that by the end of Q2, 2014, the accumulative Chinese investment stock in the U.S., was \$39.8 billion. During Q3/2014 alone, total

investment from China reached \$3.1 billion with 25 deals, including 16 mergers and acquisitions and nine green field investment deals.

There have been gradual changes in the sector structure and investors over the past year. Real estate and recreation remains a major area of Chinese investment in the U.S. Dalian Wanda Group Co. Ltd., announced a master plan for Wanda Tower in Chicago, with investment volume of \$900 million. Shortly after that, it announced another plan to build a city center on Wilshire Boulevard in Los Angeles, with a total investment of \$1.2 billion. Anbang Group, a Chinese private insurance company, purchased the Manhattan landmark Waldorf Astoria Hotel for \$1.9 billion. While this trend is likely to continue at least in the short term, there have been changes in the focus areas of investment, for example, from energy, mineral resources and food, to technology, media and telecom. Lenovo, apart from its IBM X86 purchase, has also acquired Motorola Mobile from Google for \$2.91 billion. Alibaba purchased Lyft for \$250 million. Fosun International also became a shareholder of Hollywood Studio 8.

Another apparent feature is the strong rise of private investors. According to Rhodium, private companies were involved in all 25 Chinese investment deals in the U.S. during Q3, either through direct investment or through private equity. With Wanda, Lenovo, Wanxiang, Alibaba, Fosun Tencent and others expanding worldwide, this trend will even gain further momentum in 2015.

Enormous Growth on the Horizon

The strong momentum of Chinese ODI worldwide is set to continue, at least in the short term. The first reason is due to declining returns in domestic investment. China's fixed investment has

been growing alarmingly fast since the outbreak of the global financial crisis. During the first three quarters of 2014, total fixed investment hit 35.78 trillion RMB (\$5.77 trillion), 85.2 percent of total GDP, pulling GDP growth by only 3.07 percentage points. In 2005, however, the fixed investment, with a ratio to total GDP of only 48.6 percent, contributed 4.4 percentage points to GDP growth. Key reasons behind are the widespread overcapacity and an outdated low value-added growth model. Under these circumstances, increasing numbers of Chinese enterprises, especially large private ones, are focusing more on the world markets.

Second, recent Chinese comprehensive reforms toward a market-decided resources allocation pattern serves as a strong base for going global to search the best inputs (technology, capital, designs, brands, and human resources) for maximum returns in the best market the world over.

Third, the vulnerable world economic recovery has led to low asset prices and financial needs in a number of developed economies. China, on the other hand, has the money but needs the assets.

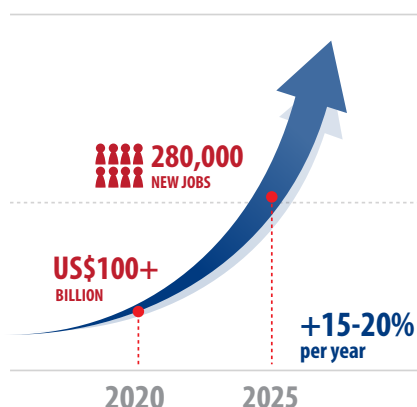
Fourth, the recent government measures of drastically liberalizing outbound investment controls have lifted the major barriers and provided a wide avenue for outbound capital flows.

However, no matter the speed of China's ODI, it is still relatively small compared to its economic size and cumulative investment stock. China's total domestic fixed investment reached 45.11 trillion RMB (\$8.15 trillion) during the first 11 months of 2014, while its ODI volume was only \$89.8 billion (non-financial), or 1.1 percent of the former. Even if it were to only double the share, the annual ODI could easily exceed \$250 billion.

China accounted for 12.4 percent of world GDP in 2013, but for only 7.6 percent of total world cross-border investment flows. By the end of 2013, China's total outbound investment stock reached \$660.48 billion, ranking 11th in the world, only 10.0 percent of the U.S. (\$6349.5 billion), 33.8 percent of UK (\$1884.82 billion), and less than two-thirds of the Netherlands (\$1071.82 billion). Apparently, there is plenty room to grow on the horizon.

It will be even more so the case of investment in the U.S. Chinese total accumulative investment stock in the U.S. just exceeded \$40 billion, less than 1 percent of the total U.S. foreign direct investment stock (\$4.9 trillion), and a far cry to that of the UK (\$511 billion). Due to the sound economic situation, a strong dollar, the higher than world average return rates, and the most sophisticated investment environment, Chinese investment in the U.S. could well keep the current strong growth in the foreseeable future.

An Open and Win-Win Approach



BY 2025
US\$200 billion

If China's annual investment flow into the US reaches US\$ 10 billion and grows by 15-20% per year, total Chinese investment stock in the US could exceed US\$ 100 billion by 2020, and US\$ 200 billion by 2025, or creating 280,000 jobs.

Source :MOFCOM

If China's annual investment flow into the U.S. reaches \$10 billion and grows by 15 to 20 percent per year, total Chinese investment stock in the U.S. could exceed \$100 billion by 2020, and \$200 billion by 2025, creating 280,000 jobs.

A potential area for future China investment in

the U.S. is infrastructure. Both countries need to identify the specific ways and paths for a successful bilateral public-private-partnership (PPP) model. A lasting, massive infrastructure construction will decisively support a new era of robust economic growth in the U.S., and in turn, contribute to China's long-term economic structural changes and upgrading.

The U.S. Department of Commerce will organize a "Select USA" road show in several Chinese cities in May 2015. Chinese local governments and business should give warm responses and get down quickly to substantive projects. Washington needs to update its notion on China and open the door widely to Chinese investment. China also needs to keep learning the specific situations in each of the potential investment locations, and work closely with American partners. Both governments need to intensify bilateral investment treaty (BIT) negotiations for an early, win-win agreement. A fast-expanding and mutual benefiting Chinese investment in the U.S. will certainly contribute to the new type of relationship between the two great nations.

CHINA US Focus

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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.

About China-US Focus

China-US Focus, published by the China-United States Exchange Foundation, is built on the principle that China and the United States hold the most important bilateral relationship of the 21st century.

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

China-United States Exchange Foundation
15/E, Shun Ho Tower
24-30 Ice House Street, Central, Hong Kong

Tel: (852) 2523 2083
Email: chinausfocus@cusef.org.hk
Website: www.chinausfocus.com

Editor's Email: zhang.ping@cusef.org.hk

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