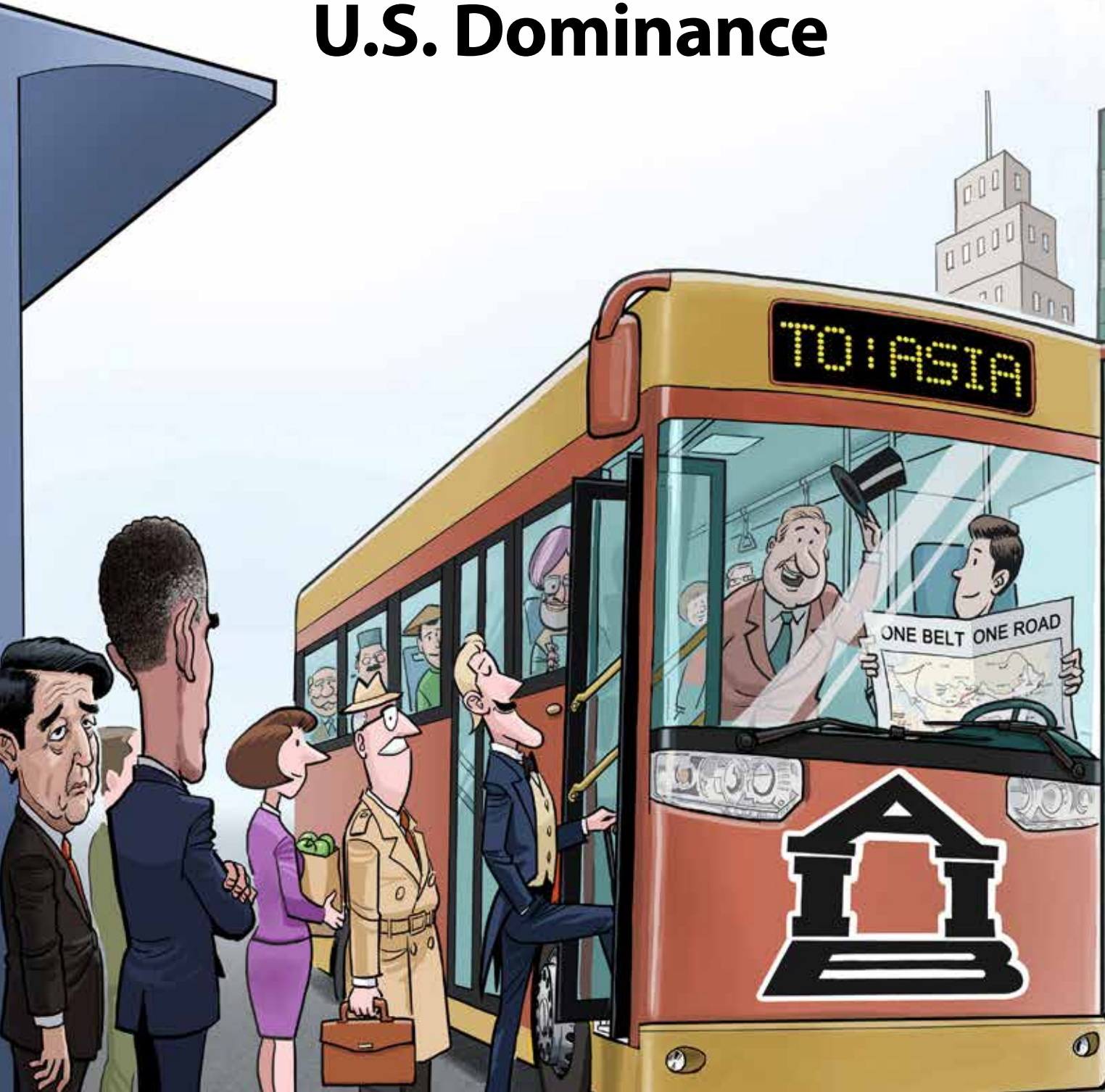


## AIIB Won't Challenge U.S. Dominance



# CHINA US Focus

ENGAGE. STIMULATE. IMPACT.

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# Editor's Note

## ZHANG PING

This issue's cover story features the Asian Infrastructure Investment Bank (AIIB), a hot issue in the recent months.

China-US Focus contributor Chen Yonglong explains that the creation of the AIIB provides a timely solution for Asia's investment, infrastructure, and growth needs, stressing that the aim of the AIIB is not to challenge U.S. dominance. He calls on the U.S. to acknowledge China's role and also welcomes its contribution.

In addressing how to understand where China is headed, Zhao Qizhen, the former spokesman of CPPCC, suggests looking at the ancient Chinese concept for peace and harmony: "He" (和). Mr. Zhao stresses that the "Chinese dream" is not just about economic and military prowess; it is also about cultural revival and contribution to the world.

Commenting on the predictions of a so-called "Chinese century," Yan Xuetong, Dean of the Institute of Modern International Relations at Tsinghua University, believes that under current world conditions, a bipolar international configuration is more likely than a multipolar or unipolar one. According to Yan, the world is witnessing increasing bipolarization as smaller nations strategically take sides with either the U.S. or China for their securitization. However, Professor Yan assures that bipolarization doesn't necessarily mean another Cold War.

On building a "new type of major-power relations," Joseph Nye, Professor at Harvard University, urges the U.S. to avoid containment as a strategy towards China, and China to accept the

legitimacy of American presence in the Western Pacific.

On President Xi Jinping's state visit to the U.S. in September, David Shambaugh, Professor at George Washington University, calls for the two countries to grasp the opportunity and for the two leaders to share their perceptions of the strategic intentions of the other side.

In a separate article, Zhang Tuosheng, Director of the China Foundation for International Strategic Studies, believes that strengthening crisis management is a priority task for China-U.S. relations.

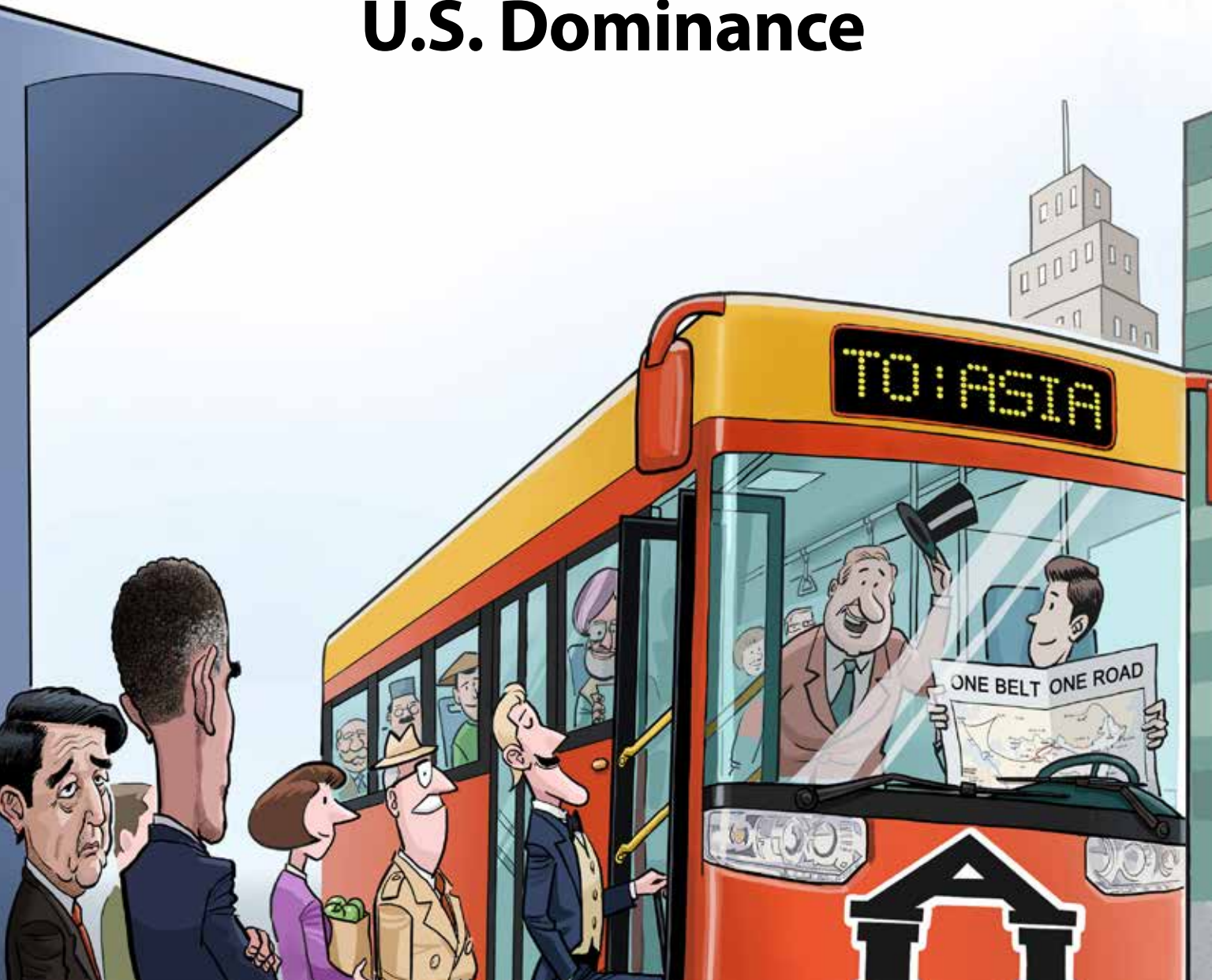
On the U.S. opposition to the AIIB, Dan Steinbock argues that this is a reflection of American exceptionalism. On China's 'One Belt, One Road' (OBOR) Strategy, Professor Shen Dingli of Fudan University makes it very clear that this is not another Marshall Plan.

We also include other articles on China-U.S. cooperation on nuclear non-proliferation and Chinese currency manipulation.

We hope this issue will allow you to review the current major issues concerning China-U.S. relations, and offer insights on ways to improve the relationship between the two countries.

Thank you.

# AIIB Won't Challenge U.S. Dominance



**Chen Yonglong**

*Director, China  
Foundation for Int'l  
Studies*

Many Western countries, the World Bank and other multilateral institutions are embracing China's proposed Asian Infrastructure Investment Bank. Their analysis concludes that the bank is a strategic asset for themselves as well as Asia, and the U.S. could benefit from the same approach.

With the number of founding members shooting up to 57 just before the deadline, the China-proposed Asian Infrastructure Investment Bank (AIIB) has proven its popularity not just within, but far beyond Asia. Whatever initial suspicion or hesitation that some non-Asian countries might have had are now clearly gone with their last-minute applications. Multilateral institutions like the World Bank, the IMF and the Asian Development Bank have also welcomed the initiative and expressed interest in cooperation.

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***Asia needs 8 trillion USD by 2020 invested in national infrastructure and another 290 billion USD in regional infrastructure to buttress growth ... The creation of the AIIB provides a timely solution.***

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Still, not everyone is happy with it. The United States, clearly disgruntled by what it views as an attempt to weaken its influence in Asia, has been raining doubts about the idea ever since it was first brought forward. Some applicants were even specifically warned not to join. The UK, for instance, irritated the United States by opting for membership. Yet not even such stark opposition from the US could turn its traditional friends and allies away from the initiative. A dozen Western countries followed the UK's suit right after its surprise announcement of application.

In fact, it is only sensible for these countries to want to make sure that they will not miss out on such a golden opportunity. From China's per-

spective, the global economic reality, to which the growth of Asia and itself matter a great deal, has changed significantly over the past few decades. As estimated by the ADB, Asia needs 8 trillion USD by 2020 invested in national infrastructure and another 290 billion USD in regional infrastructure to buttress growth, way beyond the capacity of the World Bank or any other existing financial institution in the world. The creation of the AIIB provides a timely solution, which will bridge the funding gap minus the kind of lending threshold that Asia's developing countries often find intimidating. The AIIB is not meant to replace the existing institutions but to complement and work with them to better meet the financing needs of this region.

As to how the AIIB will be operated, China has been clear all along that openness, transparency and win-win cooperation shall always be at the center of the bank, ever since Chinese President Xi Jinping first raised the idea to Indonesia's then-President Susilo Bambang Yudhoyono during his visit to the Southeast Asian nation in October 2013. Xi said the bank is designed to support regional connectivity and economic integration. A year later, the finance ministers and representatives of the first group of 22 prospective founding members signed an MOU agreeing to establish the AIIB. Even after that, China continued consultations with the US, Japan and other non-Asian countries to get them on board.

Some media reports in the US characterize the AIIB as China's tool to challenge US domination over the rules of the game in Asia. But so

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***Asia needs the U.S. to be more relaxed about China.***

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far, nothing about the AIIB seems to support that assumption. It is true that a significant part of the funding may come from China, yet the Chinese government has made it a point from the very beginning that decision-making in the AIIB will be primarily based on consensus building and thorough evaluation. The design of its institution will not give any country de facto veto power like in the World Bank or IMF. In other words, the AIIB is not poised to become a political and diplomatic lever for China to compete with the US in the financial arena. Accepting the applications of countries like the UK, France, Germany and Italy says even more about the importance the AIIB's creators attach to ensuring good governance. As a matter of fact, France and Germany have expressed confidence in the constructive role that the bank will play in Asia's economic and social development and, in turn, the global economy.

In the late 1990s, during his visit to the UK, China's then Premier Zhu Rongji was asked by the governor of the Bank of England when China would open up its capital market. The premier's answer was something to the effect that when it comes to finance, China would like to learn from the UK like a student from his teacher and open up its financial market the day it graduated. Around twenty years later, China has finally made its first major mark in the financial world by proposing the creation of the AIIB. It is also the latest sign of China's readiness to further open up the Chinese financial market. Though it is a bank for Asia, all countries, including the UK and the US, are welcome to join.

It may sound a little blunt, but Asia needs the US to be more relaxed about China. Isn't it better to invest in economic growth rather than arms

and drills? The world is no longer held together by guns and alliances. If the US wants what's best for Asia and for itself, the smart thing to do is to acknowledge China's role and welcome its contribution. According to our observation, there are signs suggesting that perhaps the US is starting to come around and just needs a bit more time before agreeing that it doesn't always have to be a zero-sum game after all.

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***If the U.S. wants what's best for Asia and for itself, the smart thing to do is to acknowledge China's role and welcome its contribution.***

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## Where China Is Headed

# The Ancient Concept of 'He (和)'



**Zhao Qizheng**

*Dean of the School  
of Journalism,  
Renmin University*

Chinese people take pride in a 2,500 year-old culture, but in the face of uncomfortable questions about China's present, they must come up with a current value that has international impact. Zhao Qizheng suggests the Chinese concept for peace/harmony: He (和). There is no need to play polemics, and pit the idea of "He" against "democracy" and "freedom."

Given the sheer size of China, its development has the ability to impact the world. With its rapid growth, China is often put under the international spotlight. However, China is very differ-

ent from many countries in terms of its cultural traditions, social system, development path, and value systems. These differences sometimes lead to doubts about China in many quarters, which

are neatly captured by the question: Where is China headed?

Indeed, international symposiums often focus on “China at a crossroads.” Many foreigners want to know the answers to the following questions: Will China pursue hegemony? Will it export instability? Will it collapse? But few have asked: Does China seek peaceful and friendly relations with the international community?

As China continues to rise, some people will continue to portray China as a threat. International forces hostile to China will amplify this narrative to check and contain China.

In the face of searching questions, Chinese officials often quote ancient classics: the Chinese people “value peace” and “seek common ground while respecting differences.” But this is not convincing enough. Foreigners will retort: How can teachings that are 2,500 years old adequately address concerns about today’s China? I would admit that these foreign critics have a point. Of course Chinese people can take pride in the glorious culture created by our ancestors, but we cannot use it to shield ourselves from uncomfortable questions.

We have to tackle the international community’s

concerns about China head-on, and explain why the Chinese system has its merits, where the country is headed, and why China is not a threat to others. Rather than quoting ancient classics, we need to bring them up to date and define the core meaning of contemporary Chinese culture. In other words, we need to give a concise, easy-to-understand answer. The best answer, in my view, is the concept of “He” (和 : peace / harmony). It is important that we discover the historical connotations of this word and expound on its current meanings in light of China’s modern history and the process of reform and opening.

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***We have to tackle the international community’s concerns about China head-on ... The best answer, in my view, is the concept of “He” (和 : peace / harmony).***

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In the modern period, China – poor, weak and using a language that was not widely spoken elsewhere – has had little cultural impact on the world. When Renaissance ideas were spread around the world by European colonialists, the philosophical pre-

cepts of ancient China were largely kept within the Middle Kingdom. Today, this sorry situation persists. The “core socialist values” that China has embraced include Western ideas of “democracy” and “freedom.” In contrast, China has yet to produce any value that has gained international acceptance.

The “Chinese Dream” is not just about economic and military prowess; it is also about cultural

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***The “Chinese Dream” is not just about economic and military prowess; it is also about cultural revival and contribution to the world.***

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revival and contribution to the world. Survey the Chinese cultural landscape, and the word “He” stands out as the most promising. A simple word with rich meanings, it stresses the opposite of “confrontation” or “difference” that often characterizes Western thinking. It is the best idea that China can offer the world, one that will provide a fresh perspective for resolving many of the difficult issues confronting the world today. If we can do a good job of explaining it, the idea stands a good chance of gaining international currency.

Conveying the messages of “peace,” “harmony,” “reconciliation,” “amity,” “preference for peaceful settlement,” “respect for differences,” “harmony is the universal path that all should pursue,” etc., “He” is held as the highest ideal for handling relations between states, between individuals, and between man and nature.

Since there is no single word in any Western language that corresponds fully to it, to avoid any simplification and misunderstanding, it may be best to introduce the original idea, not its various translations, to the world. And since a single syllable may not leave a lasting impres-

sion, it may be best to present it in the form of “Hehism.” Of course, just the word itself is not enough. There is a lot of explaining to do to make the idea stick in the Western mind.

Just one reminder: When presenting the idea of “He”, we should avoid polemics. The Chinese nation has an open mind and embraces all that is good in the world. There is no need to pit the idea of “He” against “democracy” and “freedom.” If we do it properly, the world will come to see China not just as a large and important country, but also one worthy of respect and admiration.



(Getty Images)

## Unipolar or Multipolar?

# A Bipolar World Is More Likely



**Yan Xuetong**

*Dean, Institute of  
Modern Int'l Rela-  
tions, Tsinghua  
University*

Using a formula to define “comprehensive national strength,” Yan Xuetong explains how China has increased its national strength by expanding militarily, opening up economically, and maintaining strategic alliances. The world is increasingly witnessing bipolarization due to smaller nations strategically taking sides with either the U.S. or China for their securitization, yet this doesn’t mean another Cold War.

In periods of the 19th and 20th centuries, the United Kingdom and United States maintained absolute dominance in a unipolar world, which was why they were called “British century” and

“American century.” Based on this, predictions of a so-called “Chinese century” must meet two preconditions – a unipolar international configuration and absolute Chinese dominance. It



is a matter of guesswork whether or not these two preconditions will be met in the remaining 85 years of the 21st Century. But the present-day world is heading toward a bipolar pattern featuring China and the United States.

## Chinese Comprehensive National Strength Isn't Global

Even China fulfills its second centennial goal of “building a prosperous and strong, democratic, civilized, harmonious socialist modern country” in 2049, the U.S. will not necessarily lose its superpower status thereby. International configuration is determined by two key factors – comparative strengths and strategic relationships of major powers. From the perspective of comprehensive national strength, the components of Chinese national strength are imbalanced. The country's economy has found global impacts. Its political and cultural influences are limited to the West Pacific. Its military capabilities, the weakest link in terms of national power, have hardly gone beyond perimeter defense. For instance, from March 8th to 13th, fighter jets from Myanmar had repeatedly inflicted severe damage on civilian lives and properties within Chinese borders. It is far more difficult for Chinese comprehensive national strength to catch up with that of U.S.' than for its economy to do so. Not to mention its military. The U.S. upgrades its military capabilities through war, China through military drills. The difference here is like that between corporate executives and corporate governance scholars.

From the perspective of “hard power” and “soft power,” China's global influences rest mainly on

the economic elements of its hard power. China's soft power is not only far behind that of the U.S., it may even lag behind that of Germany's. Germany is not just in an obviously dominant position in European affairs. Its impacts on non-economic, extra-regional affairs are evident. For example, during her latest visit to Japan, German Chancellor Angela Merkel warned Japanese Prime Minister Shinzo Abe to face up to history, revealing her country's advantageous position in soft power relative to Japan. Chinese leaders can't openly criticize their hosts on visits to European countries.

From the perspective of strategic relations of major powers, China only outdoes Russia and

Japan, but remains behind the U.S., Britain, France and Germany. Russia is in strategic confrontation with the U.S., Britain, France, Germany and Japan. Japan stands against both China and Russia. Though China has strategic conflicts with

both Japan and the U.S., it has better ties with Germany and France in comparison with Japan. German Chancellor Merkel paid seven visits to China in the last seven years, but only one to Japan.

Although the U.S. also has strategic conflicts with two major powers (China and Russia), its strategic relationships are of higher quality than those of China's. The U.S. adopts an alignment principle, and is in alliance with Britain, France, Germany and Japan; China follows a non-alignment policy, and is in cooperative partnerships with the U.S., Britain, France, Germany and Russia. The U.S. has about 60 allies, not including China; while China's 58 cooperative partnerships include the U.S. Joseph Nye stated in his

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***Under current conditions, a bipolar international configuration is more likely than a multipolar or unipolar one.***

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recent article “Only China Can Contain China,” that China lacks high-quality strategic partners is an indication of the gap between Chinese and American comprehensive national strengths.

### Political Might Is the Basis of Comprehensive National Strength

As Chinese economic growth slows down, some assume growth of Chinese comprehensive national strength has slowed down accordingly. However, the truth is that growth of China’s comprehensive national strength has been accelerating since the Communist Party of China’s 18th National Congress. GDP growth in China showed a trend of slowdown from 2010 to 2014. But the rise in Chinese comprehensive national strength has been faster than in previous years since 2012. Speculative provocations like, “Chinese military buildup threatens U.S. forces” and “2015 will be Year One of a Chinese century” show that the outside world has felt the accelerating rise in China’s comprehensive national strength.

Comprehensive national strength = political might × (military might + economic might + cultural might). The equation can explain why comprehensive national strength can continue growing rapidly while economic growth slows down. Anti-corruption policies and proactive foreign policies have enhanced political might from the inside and outside. Politics is operational might, and can thus yield twofold outcomes with half the effort. Accelerating upgrades in national defense over the past three years is another reason for the rapid increase in comprehensive national strength.

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$$\text{Comprehensive national strength} = \text{political might} \times (\text{military might} + \text{economic might} + \text{cultural might}).$$


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The scale of the Chinese economy has surpassed 60% of that of the U.S.’ Whether it can sustain high growth rests ultimately on if it adheres to the political trend of liberalizing its economy or “opening up.” India’s opening up came more than a decade after that of China’s. So did its acceleration in economic growth. The degree of India’s openness is less than that of China’s, and so is its growth rate.

Countries featuring long-term openness have healthier national strength than those in long-term isolation. Disintegration of the Soviet Union and “color revolutions” in the Middle East are typical examples. Since 1978, the political line of opening up has upgraded China’s comprehensive national strength in multiple

ways. It has improved citizens’ sense of right and wrong, corporate competitiveness, government capabilities for innovation, and the CPC’s capabilities for error correction, laying a solid foundation for

national self-confidence. Opening up does not guarantee realization of Chinese national rejuvenation. But not opening up would have certainly prevented the country from achieving it.

### Bipolarization Extending From East Asia to the Asia-Pacific

Prediction of a unipolar “Chinese century” is entirely contrary to the post Cold War forecast of multi-polarization. But under current conditions, a bipolar international configuration is more likely than a multipolar or unipolar one. In the next decade, no other major country except China can possibly narrow the gap between itself and the U.S. in national strength. U.S. comprehensive national strength outshines and is growing faster than those of Russia, France, Germany,

Japan, and Brazil. The gaps tend to widen. India's comprehensive national strength is below one-eighth of the U.S., and the gap between the two's absolute strengths also displays a tendency of widening. China ranks second worldwide in comprehensive national strength, and it can ensure a widening gap with those countries as long as it can maintain an equal speed of growth. It is very likely that China will grow faster. That both the U.S. and China are seeing widening gaps with other countries in national strength means it is possible that a bipolar power structure is in the making.

The trend of changes in strategic relations among major powers are more complicated than changes in relative strengths. Signs of bipolarization in strategic relations among major powers have become

evident since China and Russia came into confrontation with western powers on the Syrian crisis in 2011. The Sino-Japanese dispute over the Diaoyu

Islands in 2012 resulted in the strategic conflict featuring China and Russia against the U.S. and Japan. In 2013, the Ukraine crisis enhanced Sino-Russian strategic cooperation, at the same time consolidated U.S.-European strategic cooperation. Bipolarization is obvious now in East Asia. In security, it is a pattern of China-Russia versus U.S.-Japan; in trade, the U.S. and Japan advocate the TPP, China supports the RECP; the China-Russia led BRICS bank doesn't include the U.S. and Japan, while the U.S. and Japan refuses to take part in the China-initiated AIIB, the U.S. had even tried to persuade Australia, the Republic of Korea and others into not participating.

As the bipolar pattern emerges, small and medium-sized countries in East Asia have dis-

played side-taking tendencies in their security strategies. Mongolia can only rely on China and Russia; Cambodia, the Laos, Malaysia, Thailand are approaching China; Myanmar and North Korea are distancing themselves from China, but are yet to come close to the U.S.; the Philippines, Singapore, the ROK and Vietnam rely on the U.S. Indonesia and Brunei are sitting on the fence, ready to go with the stream. East Asia's bipolar pattern may extend to the entire Asia-Pacific. Australia has chosen to cooperate with the US and Japan strategically; Brazil has chosen to come into strategic cooperation with China.

Bipolarization doesn't mean the world is seeing another Cold War. Last century's Cold War was based on three necessary conditions: Mutual nuclear deterrence and ideological conflicts were

the main contradictions, while proxy war was the main means of competition. Under the circumstance of continuous nuclear deterrence, the core contradictions in the Sino-U.S. bipolarization are those

over international norms, instead of ideological ones, the means of competition are scientific and technological innovation as well as pursuit of friendly ties.

The Sino-U.S. bipolarization will promote changes in international configuration. The center of gravity of the world will shift from Europe to East Asia. U.S. global dominance will gradually weaken and eurocentric standards in international norms will increasingly give way to pluralist standards. The decline of global organizations and the rise of regional ones will take place simultaneously. What a bipolar international configuration to build will become a practical issue in international politics.

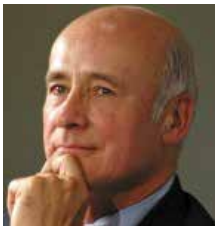
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### ***Bipolarization doesn't mean the world is seeing another Cold War.***

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# The Future of U.S.-China Relations



**Joseph S. Nye**  
*Professor, Harvard University*

The challenges that face the world are not a due to a transition of power among states, but a diffusion of power away from governments. Nye argues that for a “new type of major power relations,” the U.S. needs to avoid containment as a strategy, and China must accept the legitimacy of American presence in the Western Pacific.

When Xi Jinping visits the U.S. this autumn, one of the items on his agenda is bound to be what he has called a “new type of major power relations.” The term remains ambiguous and some Americans fear that it is a device for disrupt-

ing American alliances. Chinese scholars reply that it is a genuine effort to avoid the dangerous dynamics between a rising and an established power that helped precipitate the Peloponnesian War and World War I.



Looking ahead, pessimists predict an impending clash as China grows stronger and seeks to expel the U.S. from the Western Pacific. Some argue that this can be forestalled by the acceptance of spheres of influence in which the U.S. restricts its activities primarily to the Eastern Pacific. But such a response to China's rise would destroy American credibility and lead regional states into bandwagoning rather than balancing China. Instead, a continued U.S. presence in the Western Pacific can reinforce the natural balancing reactions of regional states and help to shape the environment in a way that encourages responsible Chinese behavior.

An appropriate policy response to the rise of China must balance realism and integration. When the Clinton Administration first considered how to respond

to the rise of China in the 1990s, some critics urged a policy of containment before China became too strong. We rejected such advice for two

reasons. First, it would have been impossible to forge an anti-China alliance since most countries in the region wanted (and still want) good relations with both the U.S. and China. Even more important, such a policy would have unnecessarily guaranteed future enmity with China. As I used to say in my speeches when I was responsible for East Asia in the Pentagon, if you treat China as an enemy, you are certain to have an enemy.

Instead the U.S. chose a policy that could be called "integrate and insure." China was welcomed into the World Trade Organization, but the U.S.-Japan security treaty was revived to insure against China becoming a bully. If a rising China throws its weight around, it drives neighbors to seek to balance its power. In that sense, only China can contain China.

This is a key point in assessing the relative power of the U.S. and China. As Yan Xuetong wrote about how China could defeat America, "to shape a friendly international environment for its rise, Beijing needs to develop more high-quality diplomatic and military relationships than Washington. No leading power is able to have friendly relations with every country in the world, thus the core of competition between China and the United States will be to see who has more high-quality friends." At this point, the United States is better placed to benefit from such networks and alliances. Washington has about 60 treaty allies; China has few. In political alignments, The Economist estimates that of the 150 largest countries in the world, nearly 100 lean toward the United States; 21 lean against.

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***If you treat China as an  
enemy, you are  
certain to have an enemy.***

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In 2011, the United States announced a strategy of rebalancing toward Asia, the fastest growing part of the world economy. Some Chinese see the Obama Administration policy of "rebalancing"

towards Asia as a form of containment, but unlike the Cold War doctrine when the U.S. had virtually no trade or social contact with the Soviet Union, it has massive trade with China and there are more than 250,000 Chinese students in American universities. Shaping the environment for Chinese decisions is a more accurate description than containment for American strategy.

Some analysts see China as a revisionist state eager to overthrow the established international order as its strength increases. But China is not a full-fledged revisionist state like Nazi Germany or the Soviet Union in the last century. While it has joined in the creation of a BRICS development bank, and promotes regional organizations that suit its needs, China has benefited

greatly from and is not eager to destroy existing international institutions such as the UN, the International Monetary Fund, and the World Trade Organization – as well as many others. American allies help shape the environment that encourages responsible behavior, and China cares about its reputation.

In addition, technological and social changes are adding a number of important transnational issues to the global agenda such as climate change, pandemics, terrorism, organized crime, and cyber crime. These issues represent not a transition of power among states, but a diffusion of power away from governments. Coping with these global threats will require increased inter-governmental cooperation that includes China, Europe and the United States and others.

to manage its relations with a rising power than Britain did a century ago, and China has more incentives for restraint than Germany had. This provides an opportunity to work out a new type of major power relationship if the U.S. continues to avoid containment as a strategy, and if China accepts the legitimacy of the American presence in the Western Pacific. Whether the United States and China will manage to develop such a relationship is another question. Human error and miscalculation are always possible. But with the right choices, conflict is not inevitable.

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***Miscalculations are  
always possible, but  
conflict is far from inevitable.***

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China aspires to play a larger role in East Asia and the U.S. has Asian allies to whose defense it is committed. Miscalculations are always possible, but conflict is far from inevitable. The legitimacy of the Chinese government depends on a high rate of economic growth; the top leaders realize that China will need many decades before it approaches the sophistication of the American economy. Where Germany was pressing hard on Britain's heels (and passed it in industrial strength), the U.S. remains decades ahead of China in overall military, economic, and soft power resources at the global level. Moreover, China cannot afford a policy like that of the Kaiser's Germany. Too adventuresome a policy risks its gains and stability at home and abroad.

In other words, the United States has more time

# Cooperation on Non-Proliferation Building A New U.S.-China 'Big Countries' Relationship



**Wu Jianmin**

*Former President,  
China Foreign Af-  
fairs University*

The recent Lausanne agreement on Iran's nuclear program is an important step forward for the international community after more than 12 years of painstaking negotiations, writes Wu Jianmin.

The recent Lausanne agreement on Iran's nuclear program is an important step forward for the international community after more than 12 years of painstaking negotiations. As Chinese Foreign Minister Wang Yi has said: "China welcomes this important consensus reached in the negotiations on Iranian nuclear issue. This is good news for the world today. The consensus has laid down a solid foundation for the parties concerned to reach a comprehensive agreement in the negotiations to come." And it is a plus for the "new model of big countries relationship" China and the US are forging.

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***When China and the U.S.,  
the two largest economies  
in the world, cooperate,  
it makes a difference.***

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this new model. As President Xi Jinping defined it at the time, this new relationship would be characterized by "no conflict, no confrontation, mutual respect and win-win cooperation."

What does "no conflict" and "no confrontation" mean? It means that President Xi Jinping and President Obama are determined to avoid the so-called "Thucydides trap". That means China and the United States will never follow the historical pattern of conflict between a rising power and an established power going back to Athens and Sparta in ancient times. They have made clear that this is their common political will.

In June 2013, President Xi Jinping and President Barack Obama reached a historical consensus at their Sunnylands summit in California, to build

What does mutual respect mean? Mutual respect is the precondition for developing cooperation between China and the United States. The rela-

tions between different countries are like the relations between human beings. Mutual respect lays the foundation for good faith cooperation. The same thing applies to the relations between major countries.

What does win-win cooperation mean? It means that both benefit by following this path as both China and the US have through economic cooperation that has achieved robust growth over the past 36 years. Win-win is a cardinal principle that will make Sino-American cooperation sustainable and enduring.

### Three Dimensions of Cooperation

China-US cooperation is multi-dimensional. It covers three areas: global challenges; bilateral trade, economic, cultural and educational cooperation; and military exchanges and security cooperation.

The common challenges facing mankind have never been so daunting as they are today — climate change, nuclear weapons proliferation, terrorism, pandemics, natural disasters, drug trafficking, just to name a few. No country, no matter how powerful it is, is able to meet these challenges alone. Common challenges bring people together. Mankind is bound to unite for its survival.



*P5+1 and Iran representative pose prior to the announcement of an agreement on Iran nuclear talks on April 2, 2015 at The Swiss Federal Institutes of Technology (EPFL) in Lausanne. Iran and world powers said they had reached agreement on Thursday on 'key parameters' of a potentially historic deal aimed at preventing Tehran from building the bomb. (FABRICE COFFRINI/AFP/Getty Images)*



When China and the US, the two largest economies in the world, cooperate, it makes a difference.

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***China-U.S. cooperation is multi-dimensional. It covers three areas: global challenges; bilateral trade, economic, cultural and educational cooperation; and military exchanges and security cooperation.***

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Such cooperation, whether on Iran, North Korea or climate change, is an important building block for the new model of the major countries relationship. The way to conceive of this relationship is as a big house. It has to be built gradually block by block. The more building blocks laid, the faster that house will be built. As President Xi Jinping has put it: "A sound China-US cooperation can become a ballast stone of world stability and a booster of world peace."

In November 2014, President Xi Jinping and President Obama made a joint pledge on reducing pollution and carbon-gas emissions. As a result, the upcoming United Nations conference on climate change to be held in Paris from Nov. 30th to Dec. 10th this year looks much more promising.

Nuclear weapons proliferation also poses a serious threat to international peace and security. Of all the global challenges it is the most complicated. The North Korean nuclear issue is the other major concern along with Iran. The Six-Party Talks on this issue have so far stalled for six years and at present show no sign of resuming any time soon. Even so, the fact that China and the US have agreed to pursue the goal of denuclearization on the Korean Peninsula has kept the issue from getting out of control. The year 1950 witnessed violent confrontation between China and the US in the Korean theater, but 2015 is not 1950. China-US cooperation has been a significant factor in keeping the lid on this conflict.



## Another U.S.-China Summit An Opportunity to Be Grasped



**David  
Shambaugh**  
*Professor, George  
Washington University*

President Xi Jinping will visit Washington D.C. in September, an essential opportunity for the leaders of the two countries to engage in action over slogans, and to share their perceptions of the strategic intentions of the other. False perceptions must be discussed and refuted in order to reinvigorate mutual trust.

It is indeed very good news that President Xi Jinping will pay a state visit to Washington D.C. in September, prior to attending the 70th anniversary of the United Nations in New York in October.

The relationship between the United States and China is the most important one in world affairs, bilaterally and multilaterally. It is therefore vitally important that the two leaders regularly communicate. For example, they had a useful telephone conversation on February 11th. They also meet each other often at international events and always take time for private meetings. But the best type of communication and interaction is when the two leaders are able to spend multiple hours in detailed discussions

with a minimum of aides present. This was the case at Sunnylands, California in 2013 and more recently in December 2014 at Yingtai in Zhongnanhai. The autumn meeting in the United States will again offer such an important opportunity for deep discussions on bilateral, regional, and global issues—building on the momentum of the successful December summit.

It is no secret that there has been, and continues to be, considerable distrust between the United States and China—both at the governmental and societal levels. While this is not conducive to building a constructive and cooperative relationship, it is also quite understandable and predictable. It is unrealistic to expect U.S.-China

relations to not include elements of distrust and competition, to some extent. Competition between major powers is quite normal, especially when the two nations have such vastly different political systems.

At the same time, the two governments should find every opportunity to work together to address challenges in regional and global affairs. No problem in the Asia-Pacific or in global governance can be effectively addressed without a deeply engaged China and active cooperation

between Beijing and Washington. China no longer has the luxury to sit on the sidelines while threats to global stability and humanity fester. However, China is still perceived as very ambivalent and reluctant to become engaged in many “hot-

spot” issues in world affairs. The current most pressing example concerns the very real threat of the Islamic State (ISIS or ISIL) in Iraq-Syria. China needs to more actively join the multinational fight against this barbaric threat to humanity—both because China has responsibility as a major power in the international community and, secondly, because China has a very real terrorism problem in Xinjiang that is directly connected to the situation in Iraq-Syria and the southern Russian Caucasus region.

It is thus very important that the two presidents continue to find areas of tangible cooperation in order to push the relationship forward. Slogans (口号) do not help in building the relationship, in

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***The relationship between the United States and China is the most important one in world affairs, bilaterally and multilaterally.***

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the view of the American side. Americans prefer to actions to words. Therefore, the U.S. Government has been reluctant to, and has not, officially endorsed President Xi's slogan of "building a new type of major country relations" (建设新兴大国关系). President Xi and the Chinese government would be better off coming to the United States in October prepared to discuss specific and substantive areas of cooperation—of which there are many—rather than trying to get agreement on this slogan.

In addition to discussing global governance issues, President Xi's visit also offers an opportunity to push forward to conclusion a bilateral investment treaty (BIT), which will be of great benefit to both countries. The United States welcomes Chinese investment and it is already growing quickly. Deepening discussions on a range of security issues, including broadening bilateral military exchanges, should also be a priority.

But perhaps the most important subject and greatest opportunity is for the two leaders to share their perceptions of the strategic intentions of the other side. Many Chinese are (wrongly) convinced that the United States seeks to contain China and subvert the Chinese government — while many Americans are convinced that China seeks to push America out of Asia and dominate

the region while challenging the American position worldwide. Both perceptions are wrong. But perceptions often have a way of becoming reality if they are not directly discussed and refuted. Presidents Xi and Obama would do well to spend some time on this subject when they sit down to talk in the White House.

All in all, the autumn summit between the two leaders offers many positive opportunities—which hopefully they will grasp, for the mutual benefit of our two great nations.

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***No problem in the Asia-Pacific or in global governance can be effectively addressed without a deeply engaged China and active cooperation between Beijing and Washington.***

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## Crisis Management Priority in China-U.S. Relations



**Zhang Tuosheng**  
*Director, China  
Foundation for Int'l  
Strategic Studies*

Previous U.S.-China issues of friction are becoming magnified again: Taiwan-Straits militarization, tension on the Korean Peninsula, maritime tension in the East and South China Seas, and security issues in cyber-space. Zhang Tuosheng calls on both nations to re-commit themselves to avoiding conflict, to strengthen and improve their liaison mechanism, to enhance the role of research, and to hold joint meetings.

The rise of geopolitical friction between China and the United States in recent years has increased chances of a military and security crisis between the two countries. Strengthening crisis management is a priority issue in China-U.S. relations.

What are the major existing and potential crises facing the two countries?

### Crisis across the Taiwan Straits

There have been several cross-Straits crises in recent history, causing serious impediments to China-U.S. relations. Since the Kuomintang took office in Taiwan in 2008, the cross-Straits situation has eased remarkably. Variables, however, still exist in the political arena there and neither China nor the U.S. has ceased preparations for possible military encounters.

The U.S. navy and air force tactics in the region are mainly designed to counter China's growing anti-access/area denial (A2/AD) capabilities. If the pro-independence Democratic Progressive Party makes a comeback in 2016, China-U.S. relations may once again face the serious challenge of cross-Straits crisis.

### **Crisis on the Korean Peninsula**

If we regard a cross-Straits crisis as having the most dangerous potential for China and the U.S., then the crisis on the Korean Peninsula can be seen as the gravest realistic crisis. To date, the Korean Peninsula has remained in a state of war. Constant flaring of nuclear ambitions, tensions between South Korea and North Korea and the strained relations between North Korea and the U.S. have combined to hike the risk of military conflict on the Peninsula. Historically, China and the U.S. were once engaged in a regional war there; and at present, the two countries have both common and divergent interests on the Peninsula. How to effectively cope with various emergencies there and avoid another war is a harsh test to both countries.

### **Crisis in the East China Sea**

Over the past two years, mounting disputes over territory and maritime rights and interests have given rise to military confrontation between China and Japan in the East China Sea. Considering the shifts in the balance of power, mutual dislike of their people and worsening political relations, maritime emergencies involving the two countries seem likely to turn into military conflict. And the U.S., as a military ally of Japan, faces a higher risk of getting embroiled in a military crisis between China and Japan. Since the latter half of 2014, China-Japan relations have somewhat improved but have yet to return to normal. Though none of the three countries

wants to see military conflict in the region, a crisis among major powers that gets out of control will no doubt cause devastating consequences and must always be treated with high precaution.

### **China-U.S. maritime conflict and crisis in the South China Sea**

In recent years, the U.S. off-shore military surveillance against China has been a major source of friction between the two countries. The air-collision incident over the South China Sea in 2001 provoked a serious crisis. Recent years have also seen a number of dangerous maritime encounters between the two countries. Usually, crises borne out of maritime emergencies are categorized as near-crises, which do not cause military conflict. When there is serious misjudgment or miscalculation, however, military conflict would be possible. Moreover, there is a growing tendency for the U.S. to meddle in the territorial disputes in the South China Sea, and the U.S. military intervention in the region is a sure way to trigger China-U.S. crisis.

### **Security crisis in outer space and cyberspace**

The rapid growth of mutual apprehension and friction between China and the US in outer space and especially in cyberspace is breeding the risk of a new type of conflict between the two countries. China has some reservations over the new concept of "cross-domain threat" raised by the U.S., believing that the security threat in outer space and cyberspace should not be pegged with nuclear threat and nuclear deterrence. On the other hand, Chinese experts also recognize the growing risk of crisis between China and the U.S. in these two global arenas, and the necessity for both countries to pay close

attention to the issue.

In addition, China and the U.S. are faced with numerous other military and security crises, including the Ukraine crisis, the geopolitical crisis in the Middle East and North Africa, and terrorism. Fortunately, these crises are more likely to advance security cooperation between the two countries than to drag them into military conflict.

The above analysis can be boiled down to two basic judgments: One, third-party factors are more likely to trigger China-U.S. crisis than bilateral factors; two, the two countries are faced with more potential crises than realistic ones.

Over the years, China and the U.S. have accumulated a host of important experience and lessons in dealing with crises. Valuable experience includes maintaining strategic restraint, safeguarding the overall interests of bilateral relations, establishing necessary communication channels, sending clear messages to each other and correctly reading each other's messages, avoiding commitment pitfalls and using military means cautiously. On the other hand, lack of understanding of each other's decision-making mechanisms, underdevelopment of bilateral crisis management mechanisms, inadequacy in crisis prevention, insufficient communication channels in the early stages of crises, and interruption from the media are among the most serious lessons the two sides have learned.

To strengthen crisis management, China and the U.S. need to make an effort in the following

areas:

First, it is essential for the leaders of the two countries to nurture their sensitivity for joint crisis management and take crisis management as a strategic measure bolstering the overall interests of bilateral relations. If the leaders of both countries are determined to avoid conflict and confrontation and willing to observe the basic principles of crisis management, the two sides would overcome the obstacles caused by their diverging interests, successfully manage crisis, and effectively avoid military conflict and war.

Second, crisis-management dialogue should become an integral part of diplomatic and defense dialogue between the two countries. If the dialogue on strategic stability is launched between the two countries, crisis management should be part of the agenda,

and realistic crisis, potential crisis and crisis that may be caused by third-party factors should all be emphasized while crisis prevention and crisis management be given equal priority. Regarding some major crises that are very sensitive and concern third parties, the two sides may negotiate in advance the conditions for emergency consultation and once the conditions are met, the consultation can be kicked off without delay.

Third, the two countries need to further strengthen and improve their liaison mechanism for crisis management. Experience shows that a separate liaison mechanism dedicated to crisis management is highly necessary. Crisis management should be included in the portfolio of the head of state and defense ministry hot lines.

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### ***Strengthening crisis management is a priority issue in China-U.S. relations.***

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As the next step, the two countries should also consider the establishment of navy and air force hot lines as well as those between the relevant war theaters of the two countries. Regular military exercises should be carried out by the crisis management communication mechanism to ensure its effectiveness in times of emergency.

Fourth, the two countries need to establish a joint working group for crisis management. Its main function should include collecting and sharing information, conducting consultation on contingency plans for crisis management, getting in touch immediately after an emergency and raising recommendations to decision makers. It is desirable that the working group is directly under the National Security Committee of China and the National Security Council of the US. Or for the time being, a 2+2 approach can be adopted that puts the group under the foreign ministries and defense ministries of the two countries.

Fifth, the two countries should deliver on the MOU on Notification of Major Military Activities Confidence-building Measures Mechanism and the MOU Regarding the Rules of Behavior for Safety of Air and Maritime Encounters that they signed at the end of 2014, and work to turn these documents into formal agreements. The two countries should also explore the possibility of formulating confidence-building measures and rules of behavior for nuclear weapons, outer space, cyberspace, anti-ballistic missiles and conventional strategic weapons. The two sides may proceed from easy issues before moving on to the more difficult ones or start with the most pressing issues before tackling other issues. The establishment of such confidence-building measures will go a long way to preventing and avoiding crises and reducing miscalculation and the risk of accidental conflict.

Sixth, the two countries should continue to expand the role of think tanks, and enhance

research on crisis management. This should include advancing track one and a half and dual-track dialogues between the think tanks of the two countries, carrying out crisis scenario discussion and simulation, and exploring crisis management measures and contingency plans. The sensitive topics concerning crisis management may first be discussed in such dialogues.

All in all, under the current circumstances, crisis management between China and the US does not just lay the groundwork for “effectively managing disputes” and keeping the bottom line of “no-conflict and no-confrontation”. It should also serve as a major tool for enhancing mutual trust, strengthening international cooperation and striving for mutual benefit. In the process of building a new model of major-country relations, it is an issue that deserves more attention from both government departments and institutes for strategic studies of the two countries.



# American Exceptionalism and AIIB Debacle



**Dan Steinbock**  
*Research Director,  
India China and  
America Institute*

Over the past two years, Washington has lobbied against the China-led Asian Infrastructure Investment Bank. Now, nearly 50 countries have joined or applied to become prospective founding members. Dan Steinbock argues that the U.S. opposition reflects a deeper challenge – that of adjusting American exceptionalism into the era of a multipolar world economy.

By the deadline of March 31, 2015, nearly 50 countries had joined or applied to become prospective founding members (PFMs) of the Asian Infrastructure Investment Bank (AIIB).

Unlike its adversaries and allies, the United States had expressed no immediate intention to participate.

That is a serious, but not entirely unexpected mistake. It is a reflection, not the cause, of a deeper challenge – that of adjusting the notion of American exceptionalism into the era of multipolar world economy.

## Chinese AIIB, American opposition

Put forward by Chinese leaders in October 2013, the proposal for the Asian Infrastructure Investment Bank (AIIB) originated from frustration. For years, China, along with other large emerging economies, had grown exasperated with the slow pace of reforms in the international multilateral financial institutions, such as the International Monetary Fund (IMF), the World Bank, and the Asian Development Bank (ADB).

In the advanced economies, these institutions

are seen as international. In the emerging world, they are perceived as dominated by American, European and Japanese interests, as reflected by their voting quotas, investment allocations and the nationalities of their leaders.

In June 2014, China proposed doubling the registered capital of the bank from \$50 billion to \$100 billion, with half from Beijing and the rest from the other founding members. In an important strategic move, China invited India to participate in the founding of the bank.

Despite pressure, U.S. allies in Southeast Asia, including Vietnam and the Philippines, joined the AIIB. Following India's footsteps, so did the rest of the South Asian economies, even Australia and New Zealand. In East Asia, South Korea joined in but Japan remains torn between its security alliance with the U.S. and trade with China. These moves, though frustrating in Washington, were not entirely unexpected.

What changed the game was the UK's participation, as the "first major Western country." Obviously, London expects the AIIB membership to facilitate the City's aspiration to become



(CHINA DAILY Graphics)

the base for the first clearinghouse for the yuan outside Asia. In the U.S., the UK announcement triggered a riled response from the Obama Administration. After Britain moved, other EU core economies – Germany, France, and Italy – followed, along with the Nordic states and, even Washington’s prime ally, Israel.

But why did Washington object to the AIIB, in the first place?

Recently, former Secretary of State Madeleine Albright said that the U.S. decision not to seek AIIB membership was a “miscalculation.” In this scenario, Washington has nothing against supporting other Chinese economic initiatives internationally. But that has not always been the case.

When the BRICS nations began to launch their development bank, the White House saw it as potential threat to the existing multilateral organizations. Also, through the Obama era, the administration has pushed for the Trans-Pacific

Partnership (TPP), which excludes China, while rejecting a regional free trade plan, which was introduced in Washington and includes both the U.S. and China. Finally, as momentum has been building for Chinese yuan to gain reserve-currency status, the Obama administration has threatened to upend Beijing's efforts.

When the UK announced its AIIB membership, a U.S. administration official said: "We are wary about a trend toward constant accommodation of China, which is not the best way to engage a rising power." That creates an impression that the administration's preferred strategy is containment (which it has denied). Be that as it may, the Obama administration is remarkably alone in its endeavor, not unlike President George W. Bush in the U.S.-led invasion of Iraq in March 2003.

Unlike the U.S., America's closest allies have no ability or willingness for global primacy, however. After all, U.S. security doctrines tend to contend that no Eurasian challengers should emerge capable of dominating Eurasia. As Zbigniew Brzezinski argued in *The Grand Chessboard* (1997), "a non-Eurasian power is preeminent in Eurasia – and America's global primacy is directly dependent on how long and how effectively its preponderance on the Eurasian continent is sustained."

In this view, the world has room for only one 'hegemon.'

## **No infrastructure, no Asian Century**

In Asia, the AIIB debate is mainly about compelling economic needs. Elsewhere, it is about the opportunity of other nations to participate in Asia's growth momentum. In Washington, the debate is about threats.

In the U.S., the AIIB has been criticized as a deliberate attempt to rival the World Bank and the ADB, even though neither of the two has the funds to support the desperately needed real infrastructure development in Asia. The ADB has less than \$80 billion in capital, while the World Bank's member states have subscribed to \$223 billion of subscribed capital. In practice, the latter can loan some \$50 billion per year.

According to ADB, what Asia needs is about \$8 trillion from 2010 to 2020.

Second, the AIIB has been portrayed as Beijing's geopolitical instrument to lure Asia closer to

China's "sphere of influence." Certainly, economic power goes hand in hand with strategic power, as evidenced by the role of the U.S. in the postwar world, especially the Marshall Plan and the North Atlantic Treaty Organization (NATO).

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***American exceptionalism will not easily adjust to the multipolar world.***

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But participating in the AIIB is not predicated on joining the Shanghai Cooperation Organization (SCO). Rather, China is offering to share the benefits of its development with the rest of Asia as Japan once did with Singapore, Hong Kong, South Korea and Taiwan.

Finally, AIIB critics have argued that the bank would not meet environmental standards, procurement requirements and other safeguards embraced by the World Bank and the ADB. That is a rosy view of these organizations, which emerging nations have criticized for years for lending, policy and staffing bias, and their advanced host economies, which cause 4-5 times more pollution than the emerging Asian nations on a per-capita basis.

The promise of the Asian century is critically

dependent on the need for infrastructure. And yet, while President Obama has spoken for more investment in Asia, his administration has opposed increasing ADB's capital base. Nor has the administration sought to persuade Congress to adopt legislation that would provide enhanced roles for China and other emerging economies in the IMF – as agreed by other countries.

## Unipolar exceptionalism

While each country may have its own sense of manifest destiny, American exceptionalism holds that the U.S. has an obligation to spread its values to every part of the world. In this sense, it is “missionary,” as Dr. Henry Kissinger likes to put it. But it also rests on bygone foundations.

In 1945, as Europe lay devastated and Japan in ruins, the U.S. emerged as the engine of the world economy. So the idea of American exceptionalism was still congruent with everyday realities. Today, the U.S. accounts for barely 20 percent of the world economy. It is no longer either the largest trader or the biggest producer but reliant on foreign investment, and it is the world's largest debtor.

In military expenditures, however, America remains the world's absolute hegemon. As a result, American exceptionalism continues to be affected by security interests. But that's a very narrow view of American exceptionalism.

In one way or another, Washington may well join the AIIB in the future. But the idea that lobbying forcefully against it was a mere miscalculation is naïve. American exceptionalism will not easily adjust to the multipolar world.

The aspiration for global primacy may be irreconcilable with American values of democracy, egalitarianism and freedom, which are better reflected by multipolarity. But old habits die hard.

Transformative times require exceptional leadership.



# China's One Belt One Road Not Another Marshall Plan



*Shen Dingli*  
Associate Dean,  
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Though some view the One Belt, One Road strategy as a Chinese version of the Marshall Plan, they are vastly different. Therefore, no single country can dominate its process. There is room to dispel suspicion and build trust by further enhancing transparency of the AIIB institution through reducing China's shareholding, offering more leadership positions to foreign nationals, and employing international business standards.

Since China proposed its 'One Belt, One Road' (OBOR) strategy two years ago, it has made significant headway. In the Eurasian area defined by this OBOR, some 60 countries have expressed their interest in partnering with this program. In addition to over two dozen Asian countries which have joined the Asian Infrastructure Investment Bank (AIIB), a new financial institution whose mission covers the OBOR, some European countries have also shown their intent to join so as to catch the opportunity to invest in this ambitious program of infrastructure connectedness across the Eurasian continent.

Despite this, advancing the OBOR strategy is not without challenges. Some have viewed it as China's Marshall Plan with a long-term goal of gaining geopolitical preeminence in the Eurasian continent. In this context, the OBOR is also deemed as an economic countermeasure to the U.S. rebalancing in the Asia Pacific. The base line is

that China will tap the opportunity of OBOR to expand investment in its extensive western neighborhood and sustain its growth rate, which is declining. China could use this strategy to hedge against potential contingencies if its sea routes become threatened. In addition, China could wield more political influence when the region's economy becomes further dependent upon Beijing.

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***The Marshall Plan,  
or European Re-  
covery Program,  
aimed at aiding those  
Western European  
countries to ride out  
those chilly years.***

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Therefore, some expect that with the progress of the OBOR strategy, a new geostrategic landscape would loom large in this part of the world. America's foremost concern is, given the emergence of the OBOR, how to sustain its dominance in the Asia Pacific and the rest of the world. The U.S. is upset by

the creation of an institutional tool such as the China-led AIIB and has challenged its transparency. It might have pressed Seoul and Canberra to be cautious in joining the AIIB. A few other actors, such as Japan and India, are wary of the



strategic implications of China's push of the OBOR idea.

For instance, Japan will not join the AIIB, worrying about its rationale, given the fact that it is already presiding over the Asian Development Bank (ADB). Though the ADB and AIIB could be complementary in eliminating regional poverty and enhancing infrastructure development, Tokyo is concerned about China's rising leadership that could undermine Japan's existing role. Despite the fact India is less ambitious about its own leadership in Asia, it is keen to watch what is happening in its backyard. China's high-handed ceremony last year to launch a harbor city project in Sri Lanka has exacerbated Delhi's concern over its traditional central role in South Asia.

To dispel some unnecessary worries, it is impor-

tant to expand the understanding of the OBOR. Though the OBOR strategy has been viewed by some as Chinese version of the Marshall Plan, they are vastly different. The Marshall Plan aimed to help recover European economy after the end of the WWII, so it was a short-term program (1947-1951). Aspiring to build Eurasian infrastructure connectedness, especially in

terms of highway, fast train and maritime transportation, the OBOR has to be a very ambitious program entailing a vast amount of resources through multilateral collaboration. Therefore, no single country can dominate its process. One shall not forget about the enormous differences in the Eurasian continent that

promises the completion of the OBOR would take tens of years if not centuries. This adds a great amount of uncertainty in the road ahead. The case of the recently selected Sri Lanka government and its subsequent halting of the afore-

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***The OBOR strategy attaches no strings and the collaborative partners are equals. It is mutually beneficial.***

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mentioned harbor city project is a clear example.

Given the challenges, it is important for various parties to understand the OBOR well. At the outset, it is crucial to clarify that the Chinese proposal is not another Marshall Plan. The Marshall Plan, or European Recovery Program, aimed at aiding those Western European countries to ride out those chilly years, through which America could both contain the left-wing there plus the Soviet bloc and tap the opportunity to boost its own economy. However, the OBOR strategy attaches no strings and the collaborative partners are equals. It is mutually beneficial. Rather than dividing the partners, the OBOR plan shall bring Asia and Europe closer.

Indeed, China's OBOR initiative attempts to attain a win-win, so China is not going to give without taking. As aforementioned, promoting Eurasian infrastructure interconnectedness would entail resources beyond anyone's own treasury, so it has to be a co-paying and co-sharing business. The Marshall Plan, nonetheless, was a U.S.-giving, Western Europe-reviving unequal arrangement at a time when the recipients had no alternative. At a globalizing age, neither America nor China is the only aid provider – there are many other sources of external support, such as the World Bank and ADB, as well as other donors like Japan. It is hard for any actors to dominate Eurasian geopolitics by merely building some railroads and harbors.

China's push has been accompanied with no preconditions. The Marshall Plan used to invite Soviet Union and Eastern European states, but with demands for economic concessions. That was why Moscow refused it and set up its own counter version, Comecon. China simply could not afford to defray all the costs of building OBOR by itself. It has to mobilize all resources

from its partners and therefore share the leadership with all stakeholders.

There is room to dispel suspicion and build trust by further enhancing transparency of the AIIB institution through reducing China's share holding, offering more leadership positions to foreign nationals, and employing international business standards. As long as a mutually beneficial cross-regional connected infrastructure system can bring about public good without allowing any single party dominance, there is no reason why such a program should not be welcome.



# Congress, China, and Currency Manipulation



**Jeffrey Frankel**

*Professor, Harvard University's Kennedy School of Government*

“Currency manipulation,” or unfair undervaluation, especially on the part of China as seen by the U.S., is a concept that is exceedingly hard to pin down from an economic viewpoint. It is true that China runs a bilateral surplus with the U.S., but as Jeffrey Frankel shows, this has little meaning for the exchange rate and competitiveness of their exports.

One of the few things on which the two parties in the U.S. Congress agree is the problem of “currency manipulation,” especially on the part of China. Perhaps spurred by the 18% appreciation of the dollar since mid-2014 and the first signs of a resulting net loss of American exports, Congress is once again considering legislation to attack currencies that are seen as unfairly un-

dervalued. The proposed measures include the threat of countervailing duties against imports from offending countries.

Even if one accepts the possibility of identifying a currency that is manipulated, however, China no longer qualifies. Under recent conditions, if China allowed its currency to float freely,



without intervention, the renminbi would more likely depreciate against the dollar than appreciate. U.S. producers would then find it harder to compete on international markets, not easier.

The concepts of manipulation or unfair undervaluation are exceedingly hard to pin down from an economic viewpoint. That China's renminbi depreciated slightly against the dollar in 2014 is not evidence: Many other currencies, most notably the yen and euro, depreciated by far more last year. As a result, the overall value of the renminbi was actually up slightly on an average basis during 2014.

The sine qua non of manipulation criteria is intervention in the foreign exchange market: selling the domestic currency, in this case, the renminbi, and buying foreign currencies, the dollar, so as keep the foreign exchange value of the domestic currency lower than it would otherwise be. To be sure, the People's Bank of China did a lot of this over the preceding ten years. Capital inflows on top of trade surpluses contributed to a huge balance of payments surplus. The authorities bought the dollars needed to make up the difference, the excess supply of dollars. The result was an all-time record level of foreign exchange reserves, reaching \$3.99 trillion by July 2014.

The situation has recently changed, however. In 2014, net capital inflows into China reversed and turned to substantial net capital outflows. As a result, the overall balance of payments turned negative in the second half of the year, which constitutes an excess demand for dollars or excess supply of renminbi. The People's Bank of China actually intervened to dampen the depreciation of its currency, the opposite of its actions over the preceding decade. As a result, foreign exchange reserves fell to \$3.84 trillion by January 2015.

There is no reason to think that this recent trend

will necessarily reverse in the near future. The downward market pressure on the renminbi relative to the dollar is easily explained by the current pattern of a relatively strong economic recovery in the U.S., prompting the end of a period of American monetary easing, together with a substantial slowing of economic growth in China, prompting the start of a new period of monetary stimulus there.

Similar economic fundamentals are now at work in other countries, particularly Japan and euro-land. When American congressmen propose to insert currency provisions into the Trans-Pacific Partnership, even though it is currently in its final stages of negotiations, they are presumably not targeting China, which is not included in the agreement, but Japan. They may also want to target the Eurozone in coming negotiations for the Transatlantic Trade and Investment Partnership. Both the yen and the euro have depreciated sharply against the dollar over the last year.

But, unlike China, it has been years since the Bank of Japan and the European Central Bank intervened in the foreign exchange market. They accepted a proposal by the U.S. Treasury to refrain from unilateral foreign exchange intervention in an unheralded G7 ministers' agreement two years ago.

Then what do those who charge Japan or the Eurozone with pursuing currency wars by pushing down the values of their currencies have in mind? They have in mind the renewed monetary stimulus of recent quantitative easing programs by those central banks. But, as the U.S. government knows well, countries with a deficiency of demand can't be asked to refrain from increasing the money supply or decreasing interest rates just because the likely effects include a depreciation of the currency. One cannot even say that the likely effects include a "beggar-thy-neighbor" rise in the trade balance, because the exchange rate effect is counteracted by an income effect

that boosts imports.

Indeed in 2010 it was the U.S. that had to explain to the world that money creation is not currency manipulation. At the time, it was the country undertaking quantitative easing and was accused by Guido Mantega, the Brazilian Finance Minister who coined the “currency wars” phrase, of being the prime aggressor. The U.S. hasn’t intervened in the foreign exchange market to sell dollars in a major way since the 1985 coordinated interventions associated with the Plaza Accord. (There was a smaller intervention to sell dollars in 2000, to help the euro.)

There are other criteria besides foreign exchange intervention that are used to ascertain whether a currency is undervalued or even “manipulated” for “unfair competitive advantage,” language that is in the IMF Articles of Agreement. One criterion is an inappropriately large surplus in its trade balance or current account balance, relative to GDP. Another is an inappropriately low foreign exchange value for the currency, in real terms. Many countries have large trade surpluses or low currencies. Sometimes they are appropriate, sometimes not. Usually it is difficult to say for sure.

China’s currency 10 years ago was unusual in that it did seem to meet all the criteria for undervaluation. The real value of the renminbi was estimated to be about 30% below equilibrium in 2005. The Chinese trade surplus reached 7% of GDP in 2007 and the current-account surplus reached 10%. But things have changed. The currency appreciated in real terms between 2006 and 2013, enough that the most recent purchasing power statistics show it in an area that is normal for a country with real income per capita around \$10,000.

The criteria that U.S. congressmen focus on has no relevance for the IMF rules or for economists: the bilateral trade balance between China

and the U.S. It is true that China runs a bilateral surplus with the U.S. that is as big as ever. At the same time, however, it runs bilateral deficits with Saudi Arabia, Australia, and other exporters of oil and minerals. Not to mention the deficit with South Korea, from whom it imports components that go into its manufactured exports. Roughly 95% of the value of a “Chinese” smart phone exported to the U.S. is represented by imported inputs; only 5% is Chinese value-added. The point isn’t that the trade statistics need to be corrected. The point is, rather, that bilateral trade balances have little meaning.

If I insisted that in return for a haircut my barber must listen to me give an economics lecture, he or she would be unlikely to consider that acceptable payment. I pay my barber in cash, and am in turn paid by Harvard University for my economics lecture. My bilateral balances are not of concern.

Congress requires by law that the U.S. Treasury report to it twice a year whether countries are guilty of manipulation, with the bilateral balance specified as one of the criteria. It would be ironic if China agreed to U.S. demands to allow the exchange rate to be determined freely in the market place and the result were a depreciation of its currency and a gain in the international competitiveness of its exporters.

## About China-United States Exchange Foundation

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.

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