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Whither China?
Implications of China’s Rise for the United States

Ali Wyne

China’s ascendance over the past decade must surely rank as one of the most remarkable phenomena of the postwar period—remarkable as much for its scale as for its unexpectedness.

China’s ascendance over the past decade is surely one of the most remarkable phenomena of the postwar period—remarkable as much for its scale as for its unexpectedness. The Great Famine, which killed some 30-40 million Chinese and caused China’s economy to contract by nearly a fifth, ended only 50 years earlier. Soon thereafter came the Cultural Revolution, which plunged the country into chaos for a decade. One who predicted in 1980—just after Deng Xiaoping had initiated his famed economic reforms—that China would be the world’s second largest economy 30 years later would likely have been seen as delusional.

The geopolitical clout that China presently enjoys is perhaps even more surprising, considering that it confronted opprobrium only two decades earlier. Shortly after stepping down as the American ambassador to China, Winston Lord urged the United States not to sever ties with China despite its crackdown on dissidents at Tiananmen Square. He conceded, however, that China had a steep hill to climb:

In a few brief months the Chinese leaders have lost the respect, confidence, and credibility they had garnered during the past decade. Their assurances on a whole range of issues will not be as readily accepted. They have squandered their special standing in world affairs. They have shaken the view that China’s entry into the international economic, security, and intellectual systems should be encouraged and facilitated.¹

While China spent much of the 1990s attempting to restore its international standing, the U.S. considered how to use the unprecedented influence that it enjoyed following the Soviet Union’s dissolution. Many American observers spoke of “the unipolar

moment," captured in Charles Krauthammer’s influential essay of that name.² Although Krauthammer made his case with greater conviction than some of his colleagues, his core proposition—that there were few, if any, serious challenges to U.S. influence—did not elicit much debate. While leading strategic thinkers held China to be a rapidly rising power, perhaps on its way to becoming a great power, they did not regard it as many do now: as a potential superpower in its own right. Here are three notable assessments:

- In 1994, Henry Kissinger predicted that the 21st-century geopolitical balance would “contain at least six major powers—the United States, Europe, China, Japan, Russia, and probably India—as well as a multiplicity of medium-sized countries.” He concluded that “[o]f all the great, and potentially great, powers, China is the most ascendant….China will show the greatest relative increase in stature among the major powers.”³

- In 1997, Zbigniew Brzezinski concluded that “even by the year 2020, it is quite unlikely even under the best circumstances that China could become truly competitive in the key dimensions of global power. Even so, however, China is well on the way to becoming the preponderant regional power in East Asia.”⁴

- In 1998, William Perry and Ashton Carter argued that “China’s rapid rise as an economic, political, and military power inevitably challenges other Pacific powers. In particular, it challenges the United States and Japan and their security alliance.” They went on to call China’s ascent “the most portentous geostrategic development in America’s westward vista.”⁵

At the time of the Perry-Carter assessment, few could have imagined that not even a decade later, then-presidential candidate Hillary Clinton would characterize the U.S.-China relationship as “the most important bilateral relationship in the world in this

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That judgment is now an assumption that most analysts take for granted when appraising the global landscape.

Given how dramatically China has risen in such a short window, it may seem premature to advise restraint in considering its prospects. It may also appear naïve to suggest that the U.S. has more staying power than most observers think. Thus did one commentator argue recently that:

the Soviet and Japanese threats to American supremacy proved chimerical. So Americans can be forgiven if they greet talk of a new challenge from China as just another case of the boy who cried wolf. But a frequently overlooked fact about that fable is that the boy was eventually proved right. The wolf did arrive—and China is the wolf.

If skepticism of this conclusion reflects a failure of imagination, confidence in a Chinese path to superpowerdom or even hegemony reflects an equally problematic recourse to extrapolation: it is misguided to infer from a current trend that the foundations for its indefinite continuation are in place. This fallacy arises most frequently in discussing the implications of China’s economic trajectory.

China’s Economy as #1

Estimating when China’s economy will surpass America’s in overall size has become something of an intellectual sport. The Economist was only half-joking when it advised readers late last year to “[f]orget Monopoly or World of Warcraft. The Economist’s idea of Christmas fun is guessing when China’s economy will leapfrog America’s to become the world’s biggest” (joining in on the fun, the magazine offered 2019 as its estimate).

It is unclear when this speculation began in earnest, although one can point to some notable estimates along the way.

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7 Gideon Rachman, “Think Again: American Decline,” Foreign Policy, No. 184 (January/February 2011): p. 59
8 Nobel Laureate Robert Fogel, for example, estimates that China’s economy will grow over 20-fold to $123 trillion by 2040; to offer some context, that figure is roughly twice last year’s gross world product. See “$123,000,000,000,000,” Foreign Policy, No. 177 (January/February 2010): p. 72.
In October 2003, Goldman Sachs stated that China’s economy could become the world’s largest as soon as 2041. ¹⁰ Four years later, in a report that focused on 11 emerging economies besides Brazil, Russia, India, and China, it mentioned in passing that it had revised its estimate down to 2027.¹¹

With the gap between America and China’s economies narrowing, observers are increasingly debating whether GDP should be calculated at purchasing power parity or market-based exchange rates. The International Monetary Fund recently predicted that China’s GDP in PPP terms will overtake America’s in 2016. In response to the debate that that judgment engendered, a spokesman for the Fund asserted that “GDP at market rates is a more relevant comparison. Under this metric, the U.S. is currently 130% bigger than China, and will still be 70% larger by 2016.”¹²

Speculation about China’s economy has produced some erroneous beliefs. Depending on which polls one considers, for example, close to or slightly over half of Americans believe that China has the world’s largest economy, even though America’s is roughly 2.5 times as large.¹³ On the other hand, some observers tend to adduce the slightest sign of trouble in China’s economy—most recently, food-induced inflation—as evidence that a hard landing is impending. Although China’s current growth rate may well be unsustainable, predictions of a Chinese crash have a poor track record.

These two strands of discussion—reflecting excessive optimism and undue pessimism, respectively—have sown unnecessary tension about China’s economic trajectory. Rather than fixating on whether its GDP will overtake America’s and attempting to pinpoint the precise date of that transition, it seems healthier to acknowledge that that transition almost certainly will occur, most likely before the middle of this century. Americans should not experience dread as this shift approaches. Indeed,

[a] decent future includes China’s GDP passing ours. They have many, many more people than we do. It’s bad for both

¹³ According to a Spring 2011 poll by Gallup, 52% of Americans believe that China is “the leading economic power in the world today.” 43% hold this view according to a poll that the Pew Research Center conducted around the same time.
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us and them if the country stays poor….In the best global economy we can imagine, the countries with the largest GDP are the countries with the most people….We want America to have the most innovative and dynamic economy in the world, and we want living in America to be better than living anywhere else. But we don’t want everywhere else to remain poor.  

Absolute GDP is a good first approximation of a country’s economic strength, but comparing the U.S. and China on that metric alone conceals more than it illuminates. “Even if overall Chinese GDP passes that of the United States around 2030,” notes Joseph Nye, “the two economies would be equivalent in size but not equal in composition. China would still have a vast underdeveloped countryside, and it will begin to face demographic problems from the delayed effects of the one child per couple policy.”

The Relationship between Resources and Outcomes

As Nye’s observation implies, the possession of power resources does not translate immediately, or necessarily at all, into the achievement of desired outcomes. Despite becoming the world’s largest economy in the 1880s, for example, the U.S. did not emerge as the world’s leading power until after the Second World War. Even that outcome was less the result of design than of circumstance: with much of Europe and Asia in ruins, the U.S. had a unique opportunity to forge and lead a postwar order.

Today, despite spending more on defense than the next 17 countries combined, and nearly six times as much as China, the second-highest spender, the U.S. has obtained dubious results in a number of countries where it has applied military force:  

- Postwar Iraq remains fragile.
- A surge of 33,000 troops into Afghanistan has produced security gains that are widely characterized as “fragile and reversible.”

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14 Ezra Klein, “We won’t always be the biggest,” The Washington Post online, available at http://voices.washingtonpost.com/ezra-klein/2011/01/we_wont_always_be_the_biggest.html (1/26/11)
Pakistan’s terror syndicate continues to thrive despite an intense campaign of drone strikes inside the country’s tribal northwest.

Al Qaeda’s affiliate in Yemen is increasingly seen as rivaling, if not having supplanted, the threat from the organization’s core.

It is also unclear that those massive expenditures have secured Americans at home. Consider the case of Faisal Shahzad, who attempted to detonate a bomb in Times Square last May. Although he failed, it would be unwise to bet that all of his successors will as well.

If the U.S. is unable to “get its way” despite the massive disproportion of its military power, it is unclear how China could do so by having the largest GDP—especially since it will be operating in an economic environment that is highly multipolar. As one observer clarified, “China will not become the world’s most powerful country on the day that it becomes the largest economy.”

What Does China Want?

Even if it did become the world’s most powerful country on that day, it is unclear what China would do to exploit that status. Discussions of possible Chinese grand strategies belie the possibility that China’s leaders may not, in fact, have one. Despite their reputation for engaging in long-term strategic thinking, they have undoubtedly been taken aback by how rapidly and significantly China has risen in just the past decade. Between 2000 and 2010, China’s GDP increased five-fold from $1.2 trillion to $5.9 trillion, and its foreign-exchange reserves increased 17-fold from $165 billion to over $2.8 trillion. By the end of this year, those figures will have increased to an estimated $6.4 trillion and $3.5 trillion, respectively. Just as a large influx of aid can overwhelm a country whose economy is comparatively small, a steep increase in power resources can challenge one that lacks a mature foreign-policy apparatus. No less than Wang Jisi, one of China’s foremost scholars of international affairs, admits that its attempt to formulate a grand strategy faces formidable obstacles:

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Defining China’s core interests according to the three prongs of sovereignty, security, and development, which sometimes are in tension, means that it is almost impossible to devise a straightforward organizing principle….Two daunting tasks lie ahead before a better-designed Chinese grand strategy can take shape and be implemented. The first is to improve policy coordination among Chinese government agencies….The second challenge will be to manage the diversity of views among China’s political elite and the general public, at a time when the value system in China is changing rapidly.¹⁸

Not everyone shares Wang’s judgment. Many respected observers believe that China has a coherent, multifaceted strategy for expanding its influence. Some, in fact, see Chinese dominance as inevitable. One of them contends that “the most important contemporary expressions of China’s civilizational tradition will come to exercise a hegemonic influence over the rest of the world.”¹⁹ More recently, a prominent economist has argued that “by 2030, relative U.S. decline will have yielded not a multipolar world but a near-unipolar one dominated by China….China’s ascendancy is imminent….the United States’ current economic situation does leave the country fundamentally vulnerable in the face of China’s inescapable dominance.”²⁰ Global public opinion on this front is even more striking. According to a report that the Pew Global Attitudes Project released this July, pluralities or majorities in 15 of 22 countries surveyed believe that China has already replaced or eventually will replace the U.S. as the world’s “leading superpower.”²¹

²¹ Pew Global Attitudes Project, “U.S. Favorability Ratings Remain Positive; China Seen Overtaking U.S. as Global Superpower” (7/13/11): p. 1. The phrase “leading superpower” raises interesting questions that lie outside the scope of this article: for example, what are the quantitative and qualitative differences between a “leading superpower” and, for lack of a better phrase, a “trailing superpower?”
A simple disaggregation of the global balance along military, economic, and political dimensions, however, casts doubt on such predictions:

- While the military balance in the Asia-Pacific will tend towards multipolarity as China’s military modernization continues, the global military balance is likely to remain unipolar for several decades, if not more.

- The economic balance, already multipolar, will become further so as economic gravity continues to move southward and eastward.

- The competition for political influence, already unremitting, will grow fiercer as technology empowers an ever-wider circle of actors to shape global narratives on the issues of the day.

It is unclear how any one country, including the U.S., could dominate geopolitics in light of these realities. What is striking, in fact, is how difficult it would be for China to achieve hegemony even in its own backyard, given the security risks that it perceives internally, the unstable geography that it confronts externally, and the formidable constraints that it faces because of America’s military presence:

At home, it devotes enormous resources, including military ones, to maintaining control over the two-fifths of its territory that comprise Xinjiang and greater Tibet, to keeping civil order throughout the densely populated and socially unstable Han heartland, and to deterring Taiwan’s independence. Around its borders, it is surrounded chiefly by two kinds of countries: unstable ones where almost any conceivable change will make life more difficult for Chinese strategists (such as Myanmar, North Korea, and the weak states of Central Asia) and strong ones that are likely to get stronger in the future and compete with China (such as India, Japan, Russia, and Vietnam). And everywhere on its periphery, on land and at sea, China faces the powerful presence of the United States.22

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The closest approximation of today’s landscape is nonpolarity, whereby international affairs are “dominated not by one or two or even several states but rather by dozens of actors possessing and exercising various kinds of power.”23 Although the U.S. and China are arguably the two most important linchpins of this nonpolar order, their ability to dictate its evolution should not be exaggerated. One analyst has likened America’s role “to the position of the largest minority shareholder in a modern corporation—a position not of control, but of substantial influence.”24 China can be thought of as the second-largest minority shareholder.

In a nonpolar system, a country’s intangible assets—its principles and ideas, for example—play an important role in determining its standing. China lacks at least two such assets that are associated with dominance: an embracive culture and a coherent set of principles to anchor global governance:

- America remains the world’s primary magnet for those who seek greater opportunities for themselves, despite maintaining an immigration policy that seems designed “to erode U.S. prosperity.”25 And it still attracts more international students than any other country, despite maintaining visa policies that are turning away growing numbers of them. James Fallows observes that “[t]oday’s China attracts outsiders, too, but in a particular way. Many go for business opportunities; or because of cultural fascination; or…to be on the scene where something truly exciting [is] under way….But China has come nowhere near the feats of absorption and opportunity that make up much of America’s story.”26 Amy Chua explains the importance of such absorption capacity: “To pull away from its rivals on a global scale, a society must pull into itself and motivate the world’s best and brightest, regardless of ethnicity, religion, or

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background. This is what every hyperpower in history has done…and the way they have done it is through tolerance.”

• The amount of commentary about the “Beijing Consensus” belies the Chinese leadership’s hesitation to speak about such a model; the lack of clarity about its main tenets; and the infeasibility of applying such tenets, even if they could be distilled, to smaller countries. Declining confidence in America’s model of political economy should not be seen as signifying growing confidence in China’s “model.” The judgment that a task force of the American Political Science Association rendered two years ago—“[t]here is, as of yet, no clear finding that U.S. relative standing is suffering in terms of credibility or esteem based on the rise of ‘competing’ models offered by Europe, China, or even Russia”—rings truer today. As the consequences of China’s massive stimulus package become more apparent, and as more commentators ask how China would cope with a renewed downturn in the West, state capitalism with Chinese characteristics will likely lose some of its luster. As David Ignatius recently lamented, “[t]he political systems in the United States and Europe have proved unable over the past year to solve crucial financial problems. The political system has been no more self-regulating than the economic….What does that leave as political-economic models? China, Russia, India, Turkey? No wonder the world is depressed.”

China’s Resource Needs

If China’s own leaders are unsure of where they envision their country in the next 25-50 years, is there anything that we can say about its grand strategy? An intriguing possibility is that its domestic imperatives leave it with little choice but to pursue policies that could be interpreted as constituting an attempt to achieve hegemony. It is this possibility that Niall Ferguson is alluding to when he observes that “the imperatives of Chinese industrialization…are forcing China more or less reluctantly

into…an informal imperial strategy.” If one accepts this hypothesis, it follows that even the most ambitious and assertive of China’s “foreign” policies are, in fact, aimed at maintaining internal stability via robust economic growth. There is certainly some plausibility to this claim: sustaining a 7-8% rate of growth, creating 20-30 million jobs annually, and otherwise ensuring the upward mobility of a fifth of humanity are Herculean enterprises.

Resource acquisition underpins China’s efforts to achieve those outcomes. Consider its share of global demand for the following commodities:

- Cement: 53%
- Iron ore: 48%
- Coal: 47%
- Steel: 45%
- Lead: 45%
- Zinc: 41%
- Aluminum: 41%
- Copper: 39%
- Nickel: 36%

Its share of global demand for various animals and foods is only slightly less staggering:

- Pigs: 46%
- Eggs: 37%
- Rice: 28%
- Soybeans: 25%
- Wheat: 17%
- Chickens: 16%

These proportions loom even larger when one considers that China’s per-capita GDP is only a tenth of America’s. Along current trend lines, China will soon have to consume the vast majority of the world’s stocks of many of these resources simply to sustain its growth. That consumption will increasingly place it conflict with other countries that require those same resources. Indeed,

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notwithstanding the technological breakthroughs that will doubtless occur in the decades ahead, the world may soon have to ask whether it has enough resources to sustain China’s growth, let alone its own.

It is not coincidental that China is asserting its interests in the energy-rich South China Sea more aggressively than just about anywhere else. For a country that presently imports 55% of its oil and will import an estimated 65% by 2030, the Sea is of singular importance.\(^{32}\)

More than half the world’s annual merchant fleet tonnage passes through these choke points [the straits of Malacca, Sunda, Lombok, and Makassar], and a third of all maritime traffic. The oil transported through the Strait of Malacca from the Indian Ocean, en route to East Asia through the South China Sea, is more than six times the amount that passes through the Suez Canal and 17 times the amount that transits the Panama Canal….about 80% of China’s crude-oil imports come through the South China Sea. What’s more, the South China Sea has proven oil reserves of 7 billion barrels and an estimated 900 trillion cubic feet of natural gas.\(^{33}\)

To hedge against overdependence on the Malacca Strait, “China is building oil and gas pipelines across Burma to the Indian Ocean, to central Asia, and to Siberia.”\(^{34}\) It has been compelled to embark on parallel “going out” campaigns in Latin America and Africa, among other locations, to secure supplies of basic commodities such as oil and those mentioned earlier. As its global footprint increases, so, too, does its exposure to unexpected events—for example, the uprisings in the Middle East and North Africa—that could jeopardize those channels.

**China’s Challenges**

Growing dependence on overseas resources is just one of the daunting challenges that China confronts going forward. Here

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\(^{33}\) Robert D. Kaplan, “The South China Sea Is the Future of Conflict,” *Foreign Policy*, No. 188 (September/October 2011): pp. 80, 82

are a few others:

- **Demographics:** China is the world’s most rapidly aging country. The elderly share of its population, about 8% last year, will reach 16% by 2030 and 24% by 2040. The ratio of working-age individuals to their elderly counterparts, close to 8:1 last year, will fall to about 4:1 by 2030 and 2.5:1 by 2040. The latest census shows that the fertility rate is well below the replacement rate of 2.1 (roughly 1.5). A prominent Chinese analyst estimates that half of China’s population will be 50 or older by the middle of the century if one assumes a fertility rate of 1.6.

- **Urbanization:** By 2025, the ranks of China’s urban population will have swelled by 400 million—roughly 100 million more people than the entire U.S. population. The McKinsey Global Institute estimates that accommodating this influx will cost $35-$40 trillion over the next two decades.

- **Water:** 40% of China’s river water is unfit for drinking, including 16% that is too contaminated for any use. China’s Ministry of Water Resources estimates that by 2030, the country’s per-capita water resources will have declined below scarcity levels. Contamination of surface water has forced China to tap into groundwater resources, leading to drops in groundwater tables of 100-300 meters in Beijing. Desertification consumes an average of 1,060 square miles of land every year.

- **Growth:** China’s leaders are the first to admit the importance of shifting toward a more consumption-driven growth model. But as one of the leading experts on China’s economy, Michael Pettis, contends, “powerful structural factors work

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against” consumption growth in China. Pettis is no China bear, and has argued that predictions of Chinese collapse are mistaken. In his judgment, continued urbanization, increased worker productivity, and financial liberalization will ensure that China “continue[s] to grow faster than the rest of the world.” Nonetheless, he sees a slowdown in Chinese growth as inevitable; the question is how long China will defer the pain that accompanies the transition away from export-centered growth.

Perhaps the greatest challenge that China confronts, however, involves the image that it presents to the world. It has strained to reconcile its ambitions for global clout with its claim to being a developing country. Maintaining that duality will grow further challenging when China supplants the U.S. as the world’s largest economy. It will be difficult for many to accept that the world’s largest economy is still “developing”—indeed, desperately poor across vast swathes. Here is how one American observer described this difficulty to a Chinese counterpart:

China may see itself as a country with multiple identities, but outsiders see one country. At the end of the day, the world will look at what China is doing and then ascribe the identity that fits best….to Americans, it seems self-servingly convenient for China to call itself a developing country when asked to contribute to the greater global good, while at the same time luring international scientific talent to some of the most advanced research facilities in the world. Most developing countries don’t present this paradox.

That paradox parallels a broader one: China’s growing confidence abroad masks growing insecurity at home (indeed, China officially spends more on internal security than on national defense). Consider its reaction to Liu Xiaobo’s receipt of the Nobel Peace Prize, its treatment of dissidents such as Ai Weiwei, its sweeping measures to forestall a “Jasmine Revolution,” its initial cover-up of the collision between two bullet trains in Zhejiang, and

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42 Michael Pettis, “China has been misread by bulls and bears alike,” The Financial Times (2/26/10): p. 11
its announcement of a “strike hard” security campaign in Xinjiang—to cite but a few measures. These specific actions should be interpreted within the context of China’s longstanding campaign to stay one step ahead of citizens who are trying to introduce greater openness—a campaign that is becoming increasingly difficult to implement. In a little over three decades, China has gone from having less than a 100 newspapers and no magazines to having 2,000 newspapers and over 9,000 magazines. And in roughly two years, microblogging services such as Sina Weibo have attracted over 220 million registered users. While public discontent with the Chinese government is nowhere near reaching the threshold that would challenge the Communist Party’s survival, it is increasing markedly. According to one estimate, there were 180,000 “mass incidents” (such as protests and riots) last year, over quadruple the figure from a decade earlier. This figure will likely grow in the years ahead. While the Party is skilled at provisioning the material needs of the poor, it is less equipped to satisfy the more intangible desires that the poor develop upon entering the middle class.

China’s leaders adduce the country’s contradictions—developed and developing, strong and weak—as evidence that its ascent is benign. Li Keqiang has argued that “it is still a developing country, facing grave challenges, and has a long way to go before it can build a moderately prosperous society and achieve modernization.” Propositions such as this one are unlikely to assuage nervous observers of China’s path, as are the narratives that China invoked when that path first started to capture the world’s attention: notably, “peaceful rise” and “harmonious development.” There is a growing gap between the expectations that those narratives produced—embodied in Robert Zoellick’s argument that China stood to advance its national interests most effectively by becoming a “responsible stakeholder” in the international system—and the emerging interpretation of China’s intentions.

China’s increasingly numerous and complex contradictions have made it difficult for the country’s leaders to reconcile the two.

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48 Li Keqiang, “The world should not fear a growing China,” The Financial Times (1/10/11): p. 11
They have produced what longtime China observer David Shambaugh calls “a schizophrenic personality”: “[m]any new voices and actors are now part of an unprecedentedly complex foreign-policymaking process….China’s international identity is not fixed. It is fluid and a work-in-progress that remains contentious and constantly debated.” Its assessment of America’s standing is similarly fluid. Indeed, the suggestion that “China” judges the U.S. to be in decline belies a robust, sophisticated debate among and between different Chinese communities including citizens, business leaders, intellectuals, military officials, and civilian leaders. Bearing in mind these divides within the Chinese policy establishment can help to temper some of the alarm about China’s rise. The more that one conceives of China as a unitary actor, considering the costs and benefits of various policies as though it were a computer, the more likely one is to impute malign intent to its rise—particularly the military component thereof. In reality, bureaucratic tensions are likely to scale with the rise of China and the sophistication of its foreign-policy apparatus. A recent illustration of that proposition has emerged from the revelation that three Chinese state-owned arms companies covertly offered $200 million in weapons to Muammar Qaddafi as he attempted to suppress Libyan rebels this summer. One account of that disclosure observed that

China’s policy toward Libya has been up for grabs [since the onset of the rebellion in Libya], with the government apparently torn between economic interest in Colonel Qaddafi’s continued rule and a desire to be on the winning side should his opponents take control….it is widely believed by outside experts that the fraternal ties between arms makers and the military…overwhelm the diplomats’ say in the process.

Such frictions afford the U.S. a strategic opportunity that rational-actor analyses of China do not detect: “Although it is not inconceivable that China might adopt more ambitious, far-flung military objectives in the future…such goals remain ill-defined, undetermined, and subject to much debate in Beijing. This

suggests that China’s future strategic orientation is susceptible to outside influence, not fixed in stone.”

U.S.-China Dynamics

The malleability of China’s strategic outlook should also give pause to those who see the Beijing Olympics, the collapse of Lehman Brothers, and the recent U.S. debt crisis as points along a confident Chinese path to superpowerdom. While outwardly logical, this narrative is misguided, as many narratives about shifts in the global balance have been. Within two decades, many observers have moved from discerning a basically unipolar environment; to advocating for an arrangement in which the U.S. and China established a “G-2”; to arguing that the U.S., debt-laden and politically paralyzed, must accommodate itself to the eventuality of Chinese dominance. The ten-year anniversary of the September 11th attacks compelled many observers to contrast what they judged to be Chinese ascent and U.S. stagnation. Bogged down in Iraq and Afghanistan, the argument goes, the U.S. essentially handed China a free decade. One commentator assembled a slew of facts in support of this case:

[T]he oil price hovers around $115 a barrel, the U.S. is projected to run a budget deficit for 2011 of $1,580 billion, the largest in its history; the economy remains deeply troubled after the financial crash of 2008; and America’s military and intelligence services remain at war, battling insurgency and radical Islamic terrorism, from Afghanistan and Pakistan to Niger and Yemen….the U.S. has belatedly woken up to China’s challenge to its dominance in the Pacific….Last year, China overtook Germany to become the world’s largest exporter. Chinese banks now rank among the biggest in the world by market capitalization….From the consumption of cement to eggs, China leads the world…China’s voracious appetite for commodities is creating new trade routes…the three most important words in the past decade were not ‘war on terror’ but ‘made in China.’

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In truth, Chinese ascendance and U.S. decline are dynamic, interconnected phenomena—especially in the economic realm. Although China’s trade exposure to the U.S. has declined, it remains substantial; last year, the U.S. absorbed 23% of its exports. In a recent editorial urging China to “end its dependency on the dollar,” a former adviser to the Chinese central bank conceded that “there is little China can do about its existing Treasury holdings.” An estimated 60% of China’s prodigious foreign-exchange reserves are dollar-denominated. Although China is reducing the dollar’s share in those reserves and pursuing multiple parallel tracks to internationalize the renminbi, those processes—particularly the second—will unfold slowly. The suggestion that America’s debt crisis will simply hasten China’s economic ascendance belies the extent to which China’s economy depends on America’s. Thus did Xinhua recently urge the U.S. to consider the global impact of its economic mismanagement:

[D]on’t forget your responsibility as the issuer of reserve currency to maintain the stable value of the dollar. Don’t become blind to the great risks that a fluctuated exchange rate could pose to international financial markets and a weak greenback could pose to the world fragile economic recovery by lifting dollar-denominated commodities prices.

Indeed, decoupling is likely to remain a “beguiling myth” for a while. The factors that make America’s economy overly reliant on consumption and China’s overly reliant on exports are strongly interwoven with both countries’ respective cultures. Furthermore, U.S.-China co-dependency has proven to be a convenient way for both countries to avoid painful but inevitable structural reforms.

The Asia-Pacific

Many argue that America’s economic woes will lead to its displacement from the Asia-Pacific, the region that offers a template for how U.S.-China relations will play out globally. While they will contribute to a decline in its relative preponderance, China is unlikely to be able to push the U.S. out of the region. What is

emerging instead is a situation in which China’s neighbors reap the economic fruits of greater ties with China while strengthening diplomatic ties with the U.S., thereby hedging against pretensions that China may harbor for regional hegemony.

This situation owes in part to institutional carryover from the Cold War: “Thanks in part to simple institutional inertia, the network of alliances that America built up in Asia during the Cold War continued to function after its end…Inertia alone cannot indefinitely sustain America’s alliances, but…it can help them to survive through future periods of turmoil and uncertainty.”57 It also owes, ironically, to U.S. disengagement from the Asia-Pacific over the past decade—ironically, because China has long confessed its hope that the U.S. would remain bogged down with military commitments, especially in the Middle East. As one Chinese official told Steven Clemons, senior fellow at the New America Foundation, China aims “to keep America distracted in small Middle Eastern countries.”58 China may well have been able to increase its regional influence more had the U.S. been more diplomatically present in the Asia-Pacific; that way, it could have portrayed itself as a counterweight to a meddlesome superpower. Instead, the absence of a robust U.S. presence has made China’s neighbors react even more strongly to its newfound assertiveness. Channeling Winston Lord from above, Walter Russell Mead reflected last September that “[t]wenty years of scrupulously patient effort at getting its neighbors to embrace China’s peaceful rise are being squandered by six weeks of aggressive diplomacy.”59 The intervening year has amplified that judgment: “over the past couple of years it [China] has managed to alarm all its neighbors….Even countries once far from the American orbit, like Vietnam and India, are being driven closer to it by China’s aggressive assertion of territorial claims.”60

The fear that China’s neighbors would be forced to “choose” between the U.S. and China has thus far not been realized. Even so, the pressure for them—Japan, South Korea, and Australia, in particular—to make a choice will increase. After all, “they are

60 “Where Asia left its heart,” The Economist, 400:8752 (9/24/11): p. 56
potentially torn allies...their security interests and future prosperity could pull increasingly in opposite directions.”\(^\text{61}\) The challenge for the U.S. and China is to sustain the delicate equilibrium that these tensions have created.

**China’s Attitude Towards the Postwar Order**

This challenge underscores the broader U.S. attempt to integrate China into the liberal international order, thereby tempering whatever revisionist tendencies it might possess; attempting to exclude it would deny the U.S. a peaceful recourse for managing China’s ascent.

China openly expresses its view that the U.S. is pursuing the former option so as to contain, perhaps even suppress, its ascent. Considering its suffering at the hands of various occupiers in the 20\(^\text{th}\) century, and its judgment that American dominance is an historical anomaly, suspicion of U.S. intentions is more or less inbuilt into China’s strategic outlook. Had the U.S. pursued containment, however, as some recommended during the 1990s and continue to recommend now, it would have aroused not suspicion, but hostility. In 1995, while serving as Assistant Secretary of Defense, Joseph Nye warned that “if you treat China as an enemy, China will become an enemy. It will become a self-fulfilling prophecy. If you have a policy of containment toward China now, you’ve written off the chance [that China will not become an enemy]. It may be a 50-50 chance, so why write off the 50%?”\(^\text{62}\)

A suspicious China that stands to lose by undercutting the postwar order—even as it challenges it and attempts to mold it gradually—is preferable to an antagonistic China that displays no equivocation in undermining that order or even establishing a countervailing one. John Ikenberry has argued that China “should face a complex and highly integrated global system—one that is so encompassing and deeply entrenched that it essentially has no choice but to join it and seek to prosper within it.”\(^\text{63}\) The evidence to date suggests that China’s revisionism will be subtle and long-


term, thereby giving the U.S. time to manage its own relative decline gracefully. As two analysts concluded recently, “the [Chinese] vision of a negotiated order supports a hedging strategy of avoiding direct confrontation with the United States but preparing favorable conditions for China to shape an emerging world order in the long term.”

**Whither U.S.-China Relations?**

However tense U.S.-China relations are now and may become, there are many constraints on the outbreak of a conflict between them, including each country’s nuclear arsenal, the two countries’ separation by the Pacific Ocean, and their high degree of economic interdependence. Other forces, however, increase tensions between the two, including frictions over U.S. arms sales to Taiwan, disputes over resolving territorial conflicts in the South China Sea, and the lack of stable military ties. The resultant of these myriad forces is likely to “produce a U.S.-China relationship that continues to be characterized by constrained, or bounded, competition.”

While U.S.-China confrontation is probably “liable to be safer if it is drenched in bromides about how the two countries need not be rivals at all,” such bromides are not a substitute for that strategic thinking. Competition between the two countries is likely to increase. After all, “the Chinese economy will continue to grow; the Chinese military will continue to modernize; and the Chinese people will remain united in their Great Power aspirations….China’s rise is a fact.” Furthermore, China is likely to adopt an increasingly expansive conception of its “core interests.”

Appealing to the Senate Foreign Affairs Committee this March not to cut the State Department’s budget, Secretary of State Clinton observed that the U.S. is “in a competition for influence with China….let’s put aside the moral, humanitarian, do-good side of what we believe in, and let’s just talk…straight realpolitik. We are

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in a competition with China.”

In less urgent language, Vice President Joseph Biden echoed that message: “[e]ven as the United States and China cooperate, we also compete. I strongly believe that the United States can and will flourish from this competition.”

They might be able to afford competing with one another; with a third of the world’s output and nearly a quarter of the world’s people between them, however, the U.S. and China cannot afford to contemplate containing each other. Perhaps the greatest impediment to achieving such understanding is that they are inexperienced at “subordinating national aspirations to a vision of a global order.” The U.S. has been the world’s leading power for roughly the last seven decades; China, with over 4,000 years of recorded history, views the U.S. as an interloper.

Given what is at stake—U.S.-China relations are likely to shape the course of the 21st century more than any other phenomenon—the temptation to offer policy prescriptions for steering that relationship forward is natural. There is indeed much that the two countries must do. The U.S. and China must consider in advance how they would respond to hypothetical events such as a Taiwanese declaration of independence or a North Korean collapse. They must consider the possibility of a conflict between them. They must imagine scenarios in which the bounded competition between them could devolve into an internecine spiral. Perhaps most importantly, however, they must accept a simple, but powerful truth: neither one of them will be able to dominate the other, let alone the world. If they concede that judgment, they may be able to avoid the fate that has befallen so many a pair of dominant and rising powers before them.

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69 Testimony before the Senate Committee on Foreign Relations, National Security and Foreign Policy Priorities in the Fiscal Year 2012 International Affairs Budget, 112th Cong., 1st sess. (3/2/11)
Beijing, Washington, and the Shifting Balance of Prestige: Remarks to the China Maritime Studies Institute

Chas W. Freeman, Jr.

The organizers of this conference recruited me to address it because I am a sort of living fossil. As a certified antique, exhumed from the diplomatic strata of the past, they thought I could not avoid having an historical perspective on things. While you were pondering naval matters today, they were sure that I would be contemplating my navel and reminiscing about ancient events. I don't want to disappoint them, so bear with me as I speak of things as they were forty years ago today — on Monday, the tenth of May 1971.

I had then just returned from training in Mandarin and Taiwanese. In the inscrutable wisdom of government personnel systems, this was thought somehow to qualify me to become, among other things, the officer-in-charge of the United States' virtually non-existent economic interaction with the China mainland. (In all of 1971, bilateral trade came to less than $5 million. We do more trade with China in a single hour now.) Instead of focusing on that not very demanding aspect of my job, on that Monday, forty years ago, I was busy at other things. Like a few other colleagues in the State Department’s Office of Asian Communist Affairs, I was writing papers in support of Henry Kissinger’s secret visit to “Pei-p’ing,” as political correctness then demanded we call it. The United States had spent more than two decades trying to destabilize and overthrow the People’s Republic, championing the lost cause of its defeated rival in the Chinese civil war, and excluding it from participation in international councils.

This was hardly an auspicious basis on which to enlist China in our then quarter-century-old grand strategy of containment of the Soviet Union. The shift from antagonism to attempted cooperation reflected realistic judgments about our international circumstances and the trajectory we were then on as a country. President Nixon recognized that our interests would be best served by abandoning failed policies and preconceptions. He boldly sought to seize
previously unimagined strategic advantages for our country. To the surprise of many, he brought this off.

To reach an accommodation with China, the United States had to choose between our longstanding politico-military commitment to Taipei and the imperatives of our national interests as affected by the Cold War. Then, as now, the Taiwan issue constrained our relations with Beijing. It threatened an eventual, bloody rendezvous between Chinese nationalism and American military power. Then, as now, war would have been disastrous for both sides. Washington and Beijing crafted our rapprochement by deferring to later resolution the casus belli between us — the question of Taiwan’s relationship with the rest of China. Both this issue and the American role in it remain unresolved. Neither Chinese nationalism nor the Taiwan issue has gone away.

China has been patient for four decades, but it is now actively pondering how best to remove the United States from what is — from its point of view — our very unhelpful residual military role in cross-Strait relations so that Beijing’s negotiators can settle the Taiwan issue with their counterparts in Taipei. That, I take it, is a principal focus of the national review of policy toward the United States that China is reportedly poised to launch. Americans cannot safely assume that China’s recent objections to U.S. arms sales to Taiwan or other military actions on our part are pro forma or “just more of the same.” It’s at least as likely that we will soon once again confront the necessity to choose between the self-imposed shackles of longstanding policy and the imperatives of our long-term strategic interests.

The underlying issue today is at root the same as forty years ago — the contradiction between U.S. policies designed to frustrate China’s achievement of its core objective of national unity and our need to reduce enmity and increase cooperation with China. But the context in which we must wrestle with this contradiction today is radically different. The balance of prestige, if not yet the balance of power, between the United States and China has shifted.

In international affairs, prestige is the shadow cast by the power of states to shape systems, attitudes, trends, and events. It is generated by the perceived decisiveness of a nation’s political system, its economic strength, and the vision and wisdom of its leadership, as well as its military prowess. Prestige is a major
determinant of the ability of a nation to preserve the privileges of
the past or frame the freedoms of the future. Current trends in this
regard do not favor the United States over China.

It is not just that China and others are regaining the regional
preeminence they enjoyed before the now defunct era of Western
colonialism. It is also that America’s fractious politics are now
dispiritng rather than inspiring to foreigners and citizens alike. The
financial system and economic model of the United States have
been discredited in the world’s eyes. Few look to us for leadership
on either global or regional issues, whatever their nature. Only our
military power is fully respected. But, as we have shown the world
in Afghanistan, Iraq, and now Libya, there are limits to what military
power alone can accomplish. China is widely seen as having its
act together. The United States is universally viewed as in big
trouble on a dismaying range of issues and not doing much, if
anything, about any of them, other than more of the same.

Our fiscal situation is a central element of this
perception. Total federal revenue, from all sources (income,
corporate, excise, social security, and medicare taxes) is now $2.2
trillion annually. Total federal transfer payments to individuals for
unemployment, pensions, medical care, and the like come to $2.4
trillion. The United States government is out of cash; it has to
borrow $200 billion even before it begins to fund its
operations. The $1.3 trillion it costs to run the government is, in
effect, all borrowed, much of it from foreigners. About $700 billion
is for the defense budget. Another $300 billion or more is military-
related but in other budgets. Total U.S. military spending comes to
well over $1 trillion. Most of our politicians remain in denial, but
growing numbers of them have begun to realize that America can’t
afford to continue anything like this level of outlays for our armed
forces.

To our creditors, America now looks like a huge, insolvent
insurance company with a mostly military workforce living on credit
rollovers. Washington can’t even pass a budget, let alone devise a
credible plan to pay down our debt. Increasingly, America’s
creditors see the United States as a bad bet, not a safe haven for
their money. This is not good. And it is not smart, in such
circumstances, to enter a race with the People’s Liberation Army,
as we did with Soviet armed forces, to see who can spend whom
into the ground.
Unlike the Soviet Union, China has a highly successful economy that is widely seen as a model combination of industrial policy with market economics. Not everybody likes China, but it has a reputation for coherent strategic vision. China does not operate an empire of captive satellite nations, have a history of global power projection, seek to export an ideology, or propose to expand beyond its traditional frontiers. It has not configured its forces for an attack on our homeland, even if it has made provision for retaliation against us in the event we strike its homeland. China has begun, however, to object to American naval operations in its near seas that it considers hostile to it. By its attempts to deny our right to carry out such operations, China jeopardizes our exercise of at least a portion of the global hegemony to which we have recently become accustomed. And the Chinese seem bent on developing defenses we cannot easily overwhelm. These are threats to our omnipotence even if they are not threats to our homeland.

China is also beginning to show a capacity to innovate militarily in ways that challenge American ingenuity. The good news is that China thus stimulates expensive new U.S. research and development projects as well as procurement and a conference or two. It is becoming a justification for “military Keynesianism.” But, as the numbers show, even without China as a major driver, military spending is already an unaffordable burden on the U.S. economy. In marked contrast, China’s defense budget is neither a significant strain on its economy nor likely to become one. With a GDP that seems destined to dwarf that of the United States in the foreseeable future, China does not anticipate resource constraints as it seeks to counter and outmatch the threat to it from America.

The United States is now fiscally hollow. Yet we are entering a long-term military rivalry with China on terms that are easily bearable by China but fiscally ruinous for us. This rivalry is all the more disadvantageous because China is competing in notably cost-effective ways, and we are not.

Aggressive reconnaissance in cyberspace is a less expensive and fatiguing way than naval and air patrols by which to probe military capabilities and map targets in other nations. Ballistic and submarine-launched cruise missiles can kill capital ships like aircraft carriers at a fraction of what it costs to build them. It’s much cheaper to shatter or blind satellites than to
launch, maintain, or protect them. Defensive measures are less demanding of human and material resources than power projection against them.

This should give us pause. In some disturbing ways, Sino-American competition is beginning to parallel the contest between us and the Soviet Union in the Cold War. This time, however, the United States is in the fiscally precarious position of the USSR, while China plays the economically robust role we once did. The political and economic weaknesses of the USSR made it unable to compete with us on any terms other than military. The huge expense of a military contest with an economically fitter enemy ultimately bankrupted the Soviet state and brought it down. Moscow’s conviction that the best defense is an overwhelmingly strong offense locked it into a military competition that, in retrospect, was as unnecessary as it was ultimately fatal.

Based on parallel logic, we have come to spend as much as the rest of the world combined on capabilities for military coercion. Our current force structure and global military posture are not dedicated to the defense of our homeland but to sustaining a credible capacity to overwhelm other nations’ ability to defend their homelands and adjacent areas, including their near seas. Americans do not worry that foreigners will impose their will on us. Our armed forces exist to impose our will on those who challenge or resist it. In this context, China’s improving defenses are only part of what drives our military strategy. Still, they loom ever larger in its sights.

As their strong preference for asymmetric counters to the instruments of American power projection illustrate, the Chinese are not just seeking security, but affordable security. Perhaps, given the state of our finances, we should do so too. But it’s hard to see how an objective of affordable security for the United States could be compatible with maintaining the assured ability to overpower China’s constantly improving defenses.

The subject you are discussing — China’s strategy for its near seas — is very relevant. The Chinese have begun to make it clear that they will not be prepared indefinitely to tolerate the long-term menace of provocative foreign naval operations near their homeland’s coasts. So it is in its near seas that China’s determination to carve out an exception to America’s global
dominion is finding its clearest expression. This determination does not make China a threat to the United States, but it reinforces the point that China is a threat to U.S. military supremacy in Asia and possibly beyond it. In this context as in others, it would seem wise to minimize activities that increase rather than diminish China’s perceived need to prepare itself for future combat with the United States. To the extent that the U.S. and PLA navies come to confront each other in China’s near seas, the stimulus for China to focus on ridding these seas of foreign threats simply increases. There is, after all, an ineluctable asymmetry at play. The United States can cease to patrol China’s near seas if it chooses, but China cannot cease to abut them.

The U.S. Navy insists on the right to conduct all sorts of operations in exclusive economic zones — EEZs — as an essential legal underpinning of our national interest in maintaining a dominant naval presence around the world. China sees its maritime perimeter through its experience of national humiliation by repeated assaults from the sea. What is a legal principle for Americans is a defense imperative for China. Such differences are unlikely to be resolved anytime soon. Nor can we assume that bringing them to a head would necessarily resolve them in our favor. The United States is not a party to the U.N. Convention on the Law of the Sea (UNCLOS) and so not in a position to avail ourselves of the Convention’s dispute resolution mechanisms. International law evolves to reflect changes in military preoccupations, technologies, and balances. Hence, the worldwide move — which the U.S. Navy stoutly resisted — from a three to a twelve-mile limit. Hence the subsequent creation, also initially opposed by the United States, of a two-hundred-mile EEZ. It’s hard to argue that American views enjoy greater international deference today than they did thirty or forty years ago.

There are many countries concerned, like China, to secure themselves from potential attack from the sea. In the post Cold War era, there are not many nations interested in preserving conditions conducive to global power projection or worldwide naval operations. If push came to shove, a majority of UNCLOS member states might support China’s views over ours. If the Chinese were to mount their own aggressive reconnaissance operations off Guam, Pearl Harbor, San Diego, and Puget Sound, even our own politicians might object to their right to do this. In a world of more than one large and competent navy, the application of the golden
rule to naval operations is an ever-present, if perhaps novel and
unwelcome, possibility.

In sum, having a legal right to do something does not make it
wise to rub others’ noses in it. Lurking offshore to satisfy a prurient
interest in the military preparedness of other nations to defend
themselves can clearly be useful. Possibly, in some
circumstances, it could be essential. But the best way to preserve
the right to do it may be to refrain from doing it too obviously, too
frequently, or too intrusively.

Antagonistic encounters in China’s near seas are a
significant factor in worsening Sino-American military relations but
they do not have the impact of U.S. moves to shore up Taiwan’s
resistance to reunion with the mainland. The Taiwan issue is the
only one with the potential to ignite a war between China and the
United States. To the PLA, U.S. programs with Taiwan signal
fundamental American hostility to the return of China to the status
of a great power under the People’s Republic. America’s
continuing arms sales, training, and military counsel to Taiwan’s
armed forces represent potent challenges to China’s pride,
nationalism, and rising power, as well as to its military
planners. These U.S. programs appear to reflect judgments by the
American elite that the Communist dictatorship on the mainland is
fundamentally illegitimate and should be prevented from extending
its sway to other parts of China even by peaceful means. U.S.
interactions with Taiwan and Tibet belie the lip service American
officials pay to the notion of “one China.” The message China’s
civilian and military elite get from these interactions is that the
United States wants “one China in name but not in fact — not now,
and perhaps never, if America has anything to say about it.” The
Chinese don’t think we should have anything to say about it.

The kind of long-term relationship of friendship and
cooperation China and America want with each other is
incompatible with our emotionally fraught differences over the
Taiwan issue. These differences propel mutual hostility and the
sort of ruinous military rivalry between the two countries that has
already begun. We are coming to a point at which we can no
longer finesse our differences over Taiwan. We must either resolve
them or live with the increasingly adverse consequences of our
failure to do so.
For Chinese, the Taiwan issue presents an increasingly stark choice between national pride commensurate with rising prestige and continuing deference to America’s waning power. With Taiwan and the mainland integrating in practice, China sees the policies of the United States as the last effective barrier to the arrival of a ripe moment for the achievement of national unity under a single, internationally respected sovereignty. Dignity and unity have been and remain the core ambitions of the Chinese revolution. China may, for now, continue to emphasize the avoidance of conflict with the United States. But the political dynamics of national honor will sooner or later force Beijing to adopt less risk-averse policies than it now espouses.

For Americans, the Taiwan issue presents an unwelcome choice between potential long-term military antagonism with China and the perpetuation, despite rapid cross-Strait economic and social integration, of Taiwan’s de facto political separation from the mainland. So far, the United States has in practice given priority to Taiwan, in what is now best described as an effort to retard the speeding tilt of the cross-Strait military balance against Taiwan. Given the huge stakes for the United States in our strategic interaction with China, this choice might well strike someone looking afresh at the situation as oddly misguided.

American priorities look all the more inverted when one considers that Beijing has offered to negotiate what amounts to purely symbolic reunification with Taiwan, forgoing any political or military presence of its own on the island. This offer cannot be dismissed as incredible. China’s willingness to tolerate amazingly different politico-economic orders on what is nominally its territory has been amply demonstrated in both Hong Kong and Macau. Its proposal to Taipei offers far greater autonomy than either of these city-states enjoy. Is it worth a war with China to prevent such an outcome? If not, why are we behaving as if it were?

Both our global military posture and our approach to China seem unlikely to work out well for us. Perhaps it’s once again time to throw off the intellectual shackles imposed by longstanding policy and address the imperatives of long-term strategic interests. Just something to think about as you plot a course for the U.S. Navy in China’s near seas.
U.S.-China Investment Ties and Issues

Wayne M. Morrison

Foreign investment often plays a major role in generating bilateral trade flows. Firms that invest overseas often import machinery, parts, and other inputs from the parent company to manufacture products for export or sale locally, which supports jobs at home. Some overseas-invested firms may produce inputs and ship them to their parent company for final production, which helps them to become more internationally competitive. Foreign investment in the United States is generally viewed as having positive benefits for the U.S. economy, although from time to time, specific types of investment by certain foreign investors—during the 1980s, it was mainly Japan; today it is mainly China.

Investment plays a major role in U.S.-China commercial ties, although many might argue that this is an area that needs to be improved. China’s investment in U.S. assets can be broken down into several categories, including holdings of U.S. securities, foreign direct investment (FDI), and other non-bond investments.¹ A significant share of China’s investment in the United States is comprised of U.S. securities, while FDI constitutes the bulk of U.S. investment in China. The Treasury Department defines foreign holdings of U.S. securities as “U.S. securities owned by foreign residents (including banks and other institutions) except where the owner has a direct investment relationship with the U.S. issuer of the securities.” U.S. statutes define FDI as “the ownership or control, directly or indirectly, by one foreign resident of 10 percent or more of the voting securities of an incorporated U.S. business enterprise or the equivalent interest in an unincorporated U.S. business enterprise, including a branch.”² The U.S. Bureau of Economic Analysis (BEA) reports data on FDI flows to and from the United States.³ China has also invested in a number of U.S.

¹ U.S. data on FDI flows to and from China differ sharply from Chinese data on FDI flows to and from the United States. This section uses U.S. data only.
² 15 CFRS 806.15(a)(1). The 10% ownership share is the threshold considered to represent an effective voice or lasting influence in the management of an enterprise. See BEA, International Economic Accounts, BEA Series Definitions, available at http://www.bea.gov/international
³ BEA also reports FDI data according to broad industrial sections, including mining; utilities; wholesale trade; information; depository institutions; finance (excluding depository institutions); professional, scientific, and technical services; non-bank holding companies; manufacturing (including food, chemicals, primary and fabricated metals, machinery, computers and electronic products, electrical equipment, appliances and components, transportation equipment, and other manufacturing); and other industries.
companies, projects, and various ventures which do meet the U.S. definition of FDI, but which, when added up, are significant.

**China's Holdings of U.S. Securities**

China’s holdings of U.S. securities are significant. These include U.S. Treasury securities, U.S. government agency (such as Freddie Mac and Fannie Mae) securities, corporate securities, and equities (such as stocks). U.S. Treasury securities, which help the federal government finance its budget deficit, are the largest category of U.S. securities held by China. As indicated in Table 1 and Figure 1, China’s holdings of Treasury securities increased from $118 billion in 2002 to nearly $1,160 billion in 2010 (year-end), and its share of total foreign holdings of U.S. Treasury securities increased from 9.6% to 26.1%, making China the largest foreign holder of U.S. Treasury securities (it overtook Japan in September 2008). The Department of the Treasury reported in May 2011 that China’s Treasury securities holdings had fallen to $1,145 billion as of March 2011. However, this figure likely understates China’s actual holdings.

China’s large holdings of U.S. securities can be largely attributed to its policy of intervening in exchange rate markets to limit the appreciation of its currency, the renminbi (RMB), to the U.S. dollar (discussed in more detail below). For example, the Chinese government requires Chinese exporters (who are often paid in dollars) to turn over their dollars in exchange for RMB. As a result, the Chinese government has accumulated a significant amount of dollars. Rather than hold onto U.S. dollars, which earn

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4 For additional information on this issue, see CRS Report RL34314, *China’s Holdings of U.S. Securities: Implications for the U.S. Economy*, by Wayne M. Morrison and Marc Labonte.

5 It is estimated China’s total holdings of U.S. securities was nearly $1.9 trillion at the end of 2010.

6 Some observers characterize foreign holdings of U.S. Treasury securities as “foreign ownership of U.S. government debt.”


8 The Department of the Treasury reports foreign holdings of U.S. Treasury securities on a monthly basis. These monthly data generally reflect the country where the purchase was made. Treasury makes revisions to its monthly data at least once a year, based on a department survey which attempts to determine the country of origin of the purchaser of the security, rather than where it was purchased. Treasury’s revisions usually show a significant increase in the estimated level of China’s Treasury holdings for that year. For example, on February 15, 2011, Treasury reported that China’s holdings of U.S. Treasury securities totaled about $892 billion at the end of 2010. But on February 23, 2011, it revised this number upward by 30% to $1,160 billion, based on the result of its survey of actual holders.
no interest, the Chinese government has chosen to invest many of them into U.S. Treasury securities because they are seen as a relatively safe investment.

Table 1. China’s Holdings of U.S. Treasury Securities: 2002-2010
($ billions and as a percent of total foreign holdings)

<table>
<thead>
<tr>
<th>Year</th>
<th>China’s Holdings ($ billions)</th>
<th>China’s Holdings as a Percent of Total Foreign Holdings</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>118.0</td>
<td>9.6%</td>
</tr>
<tr>
<td>2003</td>
<td>159.0</td>
<td>10.4%</td>
</tr>
<tr>
<td>2004</td>
<td>222.9</td>
<td>12.1%</td>
</tr>
<tr>
<td>2005</td>
<td>310.0</td>
<td>15.2%</td>
</tr>
<tr>
<td>2006</td>
<td>396.9</td>
<td>18.9%</td>
</tr>
<tr>
<td>2007</td>
<td>477.6</td>
<td>20.3%</td>
</tr>
<tr>
<td>2008</td>
<td>727.4</td>
<td>23.6%</td>
</tr>
<tr>
<td>2009</td>
<td>894.8</td>
<td>24.2%</td>
</tr>
<tr>
<td>2010</td>
<td>1,160.1</td>
<td>26.1%</td>
</tr>
</tbody>
</table>

Source: U.S. Treasury Department, year end data.

Figure 1. China’s Holdings of U.S. Treasury Securities: 2002-2010 (year-end)
($ billions)

Source: U.S. Department of the Treasury.
Many U.S. policymakers have expressed concern over China’s large holdings of U.S. securities, especially U.S. Treasury securities. They argued that although such purchases have contributed to the ability of the United States to meet its investment needs and have helped fund the growing U.S. federal budget deficit (thus helping to keep real U.S. interest rates low), they could give China increased leverage over the United States on major bilateral political and economic issues. In the 112th Congress, S.1028 (Cornyn) would seek to increase the transparency of foreign ownership of U.S. debt instruments, especially in regards to China, in order to better assess the potential risks such holdings could pose for the United States. The bill would require the President to issue a quarterly report on foreign holders of U.S. debt instruments, which would include: a breakdown of foreign ownership by country of domicile and by the type of creditor (i.e., public, quasi-public, private); an analysis of the country’s purpose and long-term intentions in regard to its U.S. debt holdings; an analysis of the current and foreseeable risks to U.S. national security and economic stability of each nation’s U.S. debt holdings; and a determination whether such risks are “acceptable or unacceptable.”

Many analysts contend that China’s holdings of U.S. debt gives it very little practical leverage over the United States. They argue that, given China’s economic dependency on a stable and growing U.S. economy, and its substantial holdings of U.S. securities, any attempt to try to “dump” a large share of those holdings would likely damage both the U.S. and Chinese economies. Such a move could also cause the U.S. dollar to sharply depreciate against global currencies, which could reduce the value of China’s remaining holdings of U.S. dollar assets. Analysts also note that, while China is the largest foreign owner of U.S. Treasury Securities, those holdings are equal to only 8.3% of

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9 Some policymakers argue, for example, that China could threaten to sell off a large share of its dollar holdings, which could have a number of significant consequences for the U.S. economy.
10 The bill states, for example, that under certain circumstances, China’s holdings of U.S. debt could give it a tool with which it can try to manipulate U.S. domestic and foreign policymaking, including the U.S. relationship with Taiwan; and that China could attempt to destabilize the U.S. economy by rapidly divesting large portions of its holdings of U.S. debt instruments.
11 If the President determines that a foreign country’s holdings of U.S. debt instruments was an unacceptable risk, he would be required to formulate an action plan to reduce that risk.
12 Some analysts counter that the ability of China to possibly disrupt the U.S. economy through selling off U.S. government debt (despite the potential costs to the Chinese economy) potentially puts the United States in a vulnerable position.
total U.S. public debt. Finally, it is argued that, as long as China continues to largely peg the RMB to the U.S. dollar, it has little choice but to purchase U.S. dollar assets in order to maintain that peg, which, it is argued, gives China very little leverage over the United States.

Over the past years, Chinese officials have expressed concern over the “safety” of their large holdings of U.S. debt. They worry that growing U.S. government debt and expansive monetary policies will eventually spark inflation in the United States, resulting in a sharp depreciation of the dollar. This would diminish the value of China’s dollar asset holdings. Several Chinese officials have publicly called for replacing the dollar as the world’s major reserve currency with some other currency arrangement, such as through the International Monetary Fund’s special drawing rights system. Most mainstream economists do not think this would be a feasible alternative in the short run.

Bilateral FDI Flows

China’s FDI in the United States is quite small relative to its investments in U.S. securities. According to the U.S. Bureau of Economic Affairs (BEA), the cumulative level of Chinese FDI in the United States through the end of 2009 was $791 million on a historical-cost (or book value) basis, while China’s investments in U.S. securities were an estimated $1.6 trillion at year-end 2009. According to the BEA, in 2009, China ranked as the 34th-largest source of cumulative FDI in the United States. Several analysts note that China often uses offshore locations (such as Hong Kong) to invest in other countries. BEA also reports cumulative FDI data according to the country of ultimate beneficial owner (UBO). Those data indicate that Chinese FDI in the United States through 2009 was actually $2.3 billion.

U.S. FDI in China is significantly higher than China’s FDI in

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13 The U.S. federal debt at the end of 2010 was $14.0 trillion. Of this amount, 40.3% was publicly-owned and 59.7% was privately-owned. Foreign investors held 53.5% of privately-owned U.S. federal debt and 31.9% of total U.S. federal debt.
15 U.S. and Chinese data on FDI flows between each other differ significantly.
16 However, according to Chinese data, its cumulative FDI in the United States from 2003 to 2009 totaled $3.3 billion.
17 BEA data on bilateral investment flows can be found at http://www.bea.gov/international/index.htm#fip.
the United States, according to BEA data. Cumulative U.S. FDI in China through 2009 was $49.4 billion (roughly the size of cumulative U.S. FDI in Spain), making it the 17th largest overall destination of U.S. FDI. U.S. FDI flows to China fell by about $7 billion in 2009, due largely to the effects of the global economic slowdown (see Table 1). According to BEA, U.S. majority-owned nonbank affiliates in China employed 774,000 workers in China in 2008.19


($ millions)

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>Cumulative: Value of FDI in 2009 Year-End</th>
</tr>
</thead>
<tbody>
<tr>
<td>China's FDI in the U.S.*</td>
<td>-62</td>
<td>150</td>
<td>146</td>
<td>315</td>
<td>137</td>
<td>368</td>
<td>-271</td>
<td>791</td>
</tr>
<tr>
<td>U.S. FDI in China</td>
<td>1,273</td>
<td>4,499</td>
<td>1,955</td>
<td>4,226</td>
<td>5,331</td>
<td>15,726</td>
<td>-6,997</td>
<td>49,403</td>
</tr>
</tbody>
</table>

Source: U.S. Bureau of Economic Analysis.

Notes: Cumulative data are on a historical-cost basis. *Excludes Chinese FDI in the United States that may have made through other countries.

Chinese Companies in the United States

Although the level of Chinese FDI in the United States is relatively small, many Chinese firms view the United States as a key part of their efforts to become more globally competitive companies, move closer to their U.S. customers, and to circumvent perceived trade and investment barriers (such as the Buy American Act). Some examples of Chinese FDI in the United States include the following:

Suntech Power Holdings Co., Ltd, the world’s largest producer of solar panels, opened a solar plant in Goodyear, AZ, in October 2010 and plans to employ 150 workers by the end of 2011.

Pacific Century Automotive Systems Co., Ltd (an entity formed by the Tempo Group and an affiliate of the Beijing Municipal Government), acquired U.S. auto parts supplier Nexteer Automotive from General Motors Co. for $420 million in November 2010. Under the agreement, Saginaw, MI, will remain as Nexteer’s global headquarters, where it reportedly employs 3,000 workers.20

Sany Group, a global producer of construction equipment, founded Sany America Inc. in 2006, headquartered in Peachtree City, GA. In 2007 announced it would invest $100 million to create and establish a manufacturing facility for constructing and engineering Sany products, with expected employment of 300 workers by the time the project is completed.\(^{21}\)

Wanxing Group, an automotive parts manufacturer, established Wanxiang America Corporation in 1994, based in Illinois. Over the past decade, Wanxing America reportedly has purchased or invested in more than 20 U.S. firms and employs 5,000 U.S. workers—more than any other Chinese company.\(^{22}\)

Other Investment Indicators

In addition to China’s FDI in the United States and its holdings in U.S. Treasury securities, China (as of June 2010) held to $127 billion in U.S. equities (such as stocks), up from $3 billion in June 2005. It also held $360 billion in U.S. agency securities, many of which are asset-backed (such as Fannie Mae and Freddie Mac securities).\(^{23}\) The China Investment Corporation (CIC), a sovereign wealth fund established by the Chinese government in 2007 with $200 billion in registered capital to help better manage China’s foreign exchange reserves, has been one of the largest Chinese purchasers of U.S. equities and other U.S. assets; it has stakes in such firms as Morgan Stanley, the Blackstone Group, and J.C. Flowers & Co.\(^{24}\) It appears that many of the investments by the CIC and other Chinese entities has attempted to avoid political controversy in the United States by limiting its ownership shares to less than 10%.

Investment Issues

Many U.S. analysts contend that greater Chinese FDI in the United States, especially in “greenfield” projects (new ventures) that manufacture products or provide services in the United States and create new jobs for U.S. workers,\(^{25}\) could help improve bilateral economic relations and might lessen perceptions among some critics in the United States that growing U.S.-China trade undermines U.S. employment and harms U.S. economic

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\(^{24}\) For more information on the CIC, see CRS Report R41441, China’s Sovereign Wealth Fund: Developments and Policy Implications, by Michael F. Martin.

\(^{25}\) According to the BEA, Chinese majority-owned nonbank affiliates in the United States employed only 1,700 U.S. workers in 2006 (most recent data available).
A number of analysts note that China’s outward FDI has been growing rapidly since around 2004 and this is likely to continue in the years ahead. Such analysts contend that greater efforts should be made by U.S. policymakers to encourage Chinese firms to invest in the United States rather than block them for political reasons.

Some critics of China’s current FDI policies and practices contend that they are largely focused on mergers and acquisitions that are geared toward boosting the competitive position of Chinese firms and enterprises favored by the Chinese government for development (some of which also may be receiving government subsidies as well). In some instances, it is argued, such investment is done largely to transfer technology and know-how to Chinese firms, but do little to help the U.S. economy. Another major problem relating to Chinese FDI in the United States is the relative lack of transparency of Chinese firms, especially in terms of their connections to the central government. Whenever Chinese state-owned enterprises (SOEs) attempt to purchase U.S. company assets, many U.S. analysts begin to ask what role has Beijing played in that decision. Many U.S. policymakers are troubled by the possibility that efforts by Chinese SOEs to acquire U.S. company assets could be part of the Chinese central government strategy to develop global Chinese firms that may one day threaten the economic viability of U.S. firms. Chinese officials contend that investment decisions by Chinese companies, including SOEs and publicly held firms (where the government is the largest shareholder), are based on commercial considerations, and have criticized U.S. investment policies as “protectionist.”

According to the Foreign Investment and National Security Act (FINSA) of 2007 (P.L. 110-149), the Committee on Foreign Investment in the United States (CFIUS) is required to conduct an investigation on the effect of the transaction on national security if the covered transaction is a foreign government-controlled transaction (in addition to if the transaction threatens to impair national security, or results in the control of a critical piece of U.S. infrastructure by a foreign person). The House report on the bill

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26 During the 1980s, Japanese firms significantly boosted their FDI in the United States, such as in automobile manufacturing, in part to help to alleviate bilateral trade tensions.
27 China reports that its overseas FDI in 2009 was $56.3 billion and accumulated overseas FDI was $245.8 billion through 2009.
28 CFIUS is an interagency committee that serves the President in overseeing the national security implications of foreign investment in the U.S. economy. See CRS Report RL33388, The Committee on Foreign Investment in the United States (CFIUS), by James K. Jackson.
(H.Rept. 110-24, H.R. 556) noted: “The Committee believes that acquisitions by certain government-owned companies do create heightened national security concerns, particularly where government-owned companies make decisions for inherently governmental—as opposed to commercial—reasons.”

In some instances, efforts by Chinese firms to acquire U.S. companies (or major parts of those companies) have raised concerns or generated controversy in the United States. To illustrate:

- In 2004, Lenovo Group Limited, a computer company primarily owned by the Chinese government, signed an agreement with IBM Corporations to purchase IBM's personal computer division for $1.75 billion. Some U.S. officials raised national security concerns over potential espionage activities that could occur in the United States at IBM research facilities by Lenovo employees if the deal went through. A review of the agreement by CFIUS took place in which IBM and Lenovo were able to address certain national security concerns and, as a result, the acquisition was completed in April 2005.  

- In 2005, the China National Offshore Oil Corporation (CNOOC), a Chinese SOE, made a bid to buy UNOCAL, a U.S. energy company, for $18.5 billion, but widespread opposition in Congress led CNOOC to withdraw its bid. Some Members argued at the time that the proposed takeover represented a clear threat to the energy and national security of the United States, would put vital oil assets in the Gulf of Mexico and Alaska into the hands of a Chinese state-controlled company, could transfer a host of highly advanced technologies to China, and that CNOOC's bid to take over UNOCAL would be heavily subsidized by the Chinese government. Some Members contended that “vital” U.S. energy assets should never sold to the Chinese government. CNOOC

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29 IBM and Lenovo reportedly agreed to address national security concerns by CFIUS. For example, it was agreed that 1,900 employees from a North Carolina research facility, which IBM had shared with other technology companies, would move to another building. See the Financial Times, “US State Department limits use of Chinese PCs,” May 18, 2006.
officials referred to U.S. political opposition to the sale as “regrettable and unjustified.”

- In September 2007, the Chinese firm, Huawei Technologies Co., Ltd, a leading global telecommunications equipment supplier, announced plans, along with its partner, Bain Capital Partners, to buy the U.S. firm 3Com Corporation, a provider of data networking equipment, for $2.2 billion. However, the proposed merger was withdrawn in February 2008 following a review of the deal by CFIUS when Huawei and its partner failed to adequately address U.S. national security concerns raised by CFIUS members.

- In July 2009, China’s Northwest Nonferrous International Investment Company, a Chinese SOE, made a $26 million offer to purchase a 51% stake in the Firstgold Corporation, a U.S. exploration-stage company. However, the deal reportedly raised national concerns within CFUIS because some of the mines controlled by Firstgold were near U.S. military installations. As a result, the Chinese firm withdrew its bid in December 2009.

- In February 2010, Emcore Corporation, a provider of compound semiconductor-based components, subsystems, and systems for the fiber optics and solar power markets, announced it had agreed to sell 60% interest in its fiber optics business (excluding its satellite communications and specialty photonics fiber optics businesses) to China’s Tangshan Caofeidian Investment Corporation (TCIC) for $27.8 million. However, Emcore announced in June 2010 that the deal had been ended because of concerns by CFUIS.

30 The Senate report of its version of FINSA (S.Rept. 110-80, S. 1610) noted that CNOOC’s attempt to acquire UNOCAL “led many members of Congress to raise questions about the transfer of ownership or control of certain sectors of the U.S. economy to foreign companies, especially to foreign companies located within or controlled by countries the governments of which might not be sympathetic to U.S. regional security interests.”


• In May 2010, Anshan Iron and Steel Group Corporation (Ansteel), a major Chinese state-owned steel producer, announced plans to form a joint venture with the U.S. firm Steel Development Company in Mississippi to build and operate four mills to produce reinforcing bar and other bar products used in infrastructure applications, and one mill that would be capable of producing electrical and silicon grades of steel used in energy applications. In July 2010, the Congressional Steel Caucus sent a letter signed by 50 Members to Secretary of the Treasury Tim Geithner, expressing concerns over the effect the investment would have “on American jobs and our national security.”

• In May 2010, Huawei bought certain intellectual property assets of 3Leaf Systems (an insolvent U.S. technology firm) for $2 million. A February 2011 letter by issued Senators Jim Webb and Jon Kyl to Commerce Secretary Gary Locke and Treasury Secretary Tim Geithner stated: “We are convinced that any attempt Huawei makes to expand its presence in the U.S. or acquire U.S. companies warrants thorough scrutiny. Moreover, the 3Leaf acquisition appears certain to generate transfer to China by Huawei of advanced U.S. computing technology. Allowing Huawei and, by extension, communist China to have access to this core technology could pose a serious risk as U.S. computer networks come to further rely on and integrate this technology.” In February 2011, Huawei stated that CFIUS had formally notified Huawei that it should withdraw its application to acquire 3Leaf’s assets, which it later did. In an “Open Letter,” Huawei

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33 A press release by Ansteel stated that its intentions are “to capitalize on the opportunity to enter into an overseas joint venture with a company that is focused on utilizing advanced technology in an environmentally friendly and highly profitable manner.” See, http://www.steeldevelopment.com/documents/ansteel2010.pdf.


35 The letter also raised concerns over allegations that Huawei had ties to the Iranian government, had received substantial subsidies from the Chinese government, and had a poor record of protecting intellectual property rights.

36 Huawei initially stated that it would decline CFIUS’s recommendation with the intent of going through all of the procedures of the CFIUS process (including a potential decision by the President) inter order to “reveal the truth about Huawei.”
invited the U.S. government to carry out a formal investigation on any concerns it may have about Huawei.  

U.S. Concerns over China’s Investment Regime

U.S. trade officials have urged China to liberalize its investment regime as part of their efforts to expand U.S. exports to China. Although China is one of the world’s top recipients of FDI, the Chinese central government imposes numerous restrictions on the level and of types of FDI allowed in China. To a great extent, China’s investment policies appear to be linked to industrial policies that seek to promote the development of key industries in China. FDI inflows are viewed by the government as a method to help Chinese domestic firms gain access to capital, technology, and know-how, which, it is hoped, will help speed up their development. In many cases, the level and scope of FDI in China is restricted in order to prevent foreign firms from dominating any one sector. For example, the Chinese government has made the development of its domestic auto industry a top priority. To that end, the government has encouraged foreign auto companies to invest in China, but limits FDI in that sector to 50-50 joint venture. Many critics contend that the Chinese government often requires foreign firms to transfer technology to their China partners, and sometimes to set up research and development facilities in China, in exchange for access to China’s markets.

The United States and China are currently negotiating a bilateral investment treaty (BIT) with the goal of expanding bilateral investment opportunities. U.S. negotiators hope such a treaty would improve the investment climate for U.S. firms in China by enhancing legal protections and dispute resolution procedures, and by obtaining a commitment from the Chinese government that it would treat U.S. investors no less favorably than Chinese investors. However, some U.S. groups have expressed reservations concerning a China-U.S. BIT, arguing that it would encourage U.S. firms to relocate to China.

Concluding Observations

China’s rise as a major economic power has presented
numerous challenges and opportunities for the United States, one of which is the development of policies to better promote and manage bilateral investment flows. The Obama Administration has attempted to assure China that Chinese investment in the United States is welcomed and encouraged. However, Chinese officials have complained a number of occasions that the United States discriminates against Chinese firms that want to invest in the United States. During the May 2011 round of the U.S.-China Strategic & Economic (S&ED) dialogue, the two sides stated that they “recognize the importance of open trade and investment for promoting innovation, creating jobs, and boosting incomes and economic growth. The United States and China are committed to further expanding bilateral trade and investment, fostering more open trade and investment globally, and fighting against trade and investment protectionism,” and that they were “committed to fostering open and fair investment environments, and continuing to promote transparency and predictability for investors of both countries.”

Certainly, U.S. policymakers would generally support the types of Chinese FDI in the United States that would create badly needed jobs. This might also help alleviate concerns in the United States that economic ties with China have undermined U.S. employment, especially in manufacturing. However, many U.S. policymakers are deeply concerned over Beijing’s global investment strategy. Most of China’s overseas investment efforts have been made by SOEs, rather than private firms. China claims that SOEs are profit-motivated and are not controlled, influenced, or financed by Beijing. Many in the United States are not so sure about this, and many believe that China’s main motivation is to buy up U.S. technology at bargain basement prices in an effort to boost the competitiveness of Chinese goods at the expense of the United States. China could improve this situation by boosting the level of transparency of its firms that want to invest in the United States, including opening their books to private independent auditors. China should also have a neutral overseas investment policy, which enable allow private Chinese firms to boost their overseas investment, not just try to promote FDI by SOEs, which adds to suspicions that China’s FDI is state-directed.

“Reciprocity” is a term that is extensively used by U.S. policymakers, especially in Congress, to describe a fair and equitable economic relationship with a foreign country, such as in terms of trade. Many such policymakers contend that China’s
investment policies are highly restrictive (such as those that permit investments only through a joint venture with a Chinese partner and, in many cases unfair, (such as when foreign firms are forced to transfer technology to a Chinese partner as the cost of doing business in China. Many contend that Chinese investment in the United States should be restricted or discouraged until China affords U.S.-invested firms in China a more open and fair investment environment.
The Shifting Fortunes of Public and Private Economies: The Chinese Debate on “Guojin Mintui”

Dali Yang, Ph.D. and Junyan Jiang

Although China in the reform era has undergone substantial economic liberalization and witnessed major efforts to downsize and rationalize a dirigiste state, it has taken a somewhat different turn in recent years. Since around 2004, observers have noted not only a major uptick in the degree of state intervention in many policy areas, but also the revival of the formerly moribund state-own enterprises (SOEs) as measured by profitability as well as their sheer scale of influence.

The shifting economic patterns have not only affected the fate of business players in specific sectors but also have produced major repercussions in the public sphere. As Chinese SOEs repeatedly made the headlines with ambitious plans for expansions and major takeovers at a time when the export-dependent private sector was contending with a severe downturn in global markets, the Chinese media came up with the phrase guojin mintui, literally “the state (-owned sector) advances and the private [sector] retreats.” Following on the heels of the Zhu Rongji era, when privatization seemed to be the main trend, the guojin mintui phenomenon reignited the long-standing debate about the proper role of the state in the economy.

The global economic crisis that originated in the United States put the economics profession on the defensive.\(^1\) Facing the growing assertiveness of the state sector, China’s champions of market forces have especially felt lonely. For them, the guojin mintui phenomenon, coupled with the relative stasis in other policy arenas, raises fears back-sliding in reforms. Wu Jinglian (吴敬琏), one of the most prominent liberal economists, has on many occasions framed reform as a continuous struggle between market forces and vested political interests. He warns that excessive government involvement would only distort the market mechanism and open up rent-seeking opportunities which empower the privileged.\(^2\) Zhang Weiying (张维迎), former Dean of the Guanghua

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School of Management at Beijing University, warns that the growing role of state enterprises could stifle the potential of Chinese entrepreneurs and lead China into stagnation.  

Many others, such as Sheng Hong (盛洪), have decried the unfair advantages the central-government SOEs have enjoyed including retention of profits, exemptions from resource royalties and land-use privileges, and called for the government to exercise its right as owner and ask these corporate giants to shoulder more social and fiscal responsibilities. In 2011, the Unirule Economic Research Institute, at which Sheng has served as the director, published an extensive research report on the nature, performance and reform of State-owned Enterprises. The report argues that the real rate of return on asset for SOEs, after subtracting all the economic privileges, was about -1.47% for the 2001-2009 period, compared with the nominal rate of 8.18%. At the end of the report, Sheng and other authors contended that the current reform agenda for SOEs, which focuses on capitalization and profit-generation, has worked in the past but is now an outmoded strategy that must end with the rise of the market economy. They called for dismantling the privileges and monopolistic status the SOEs enjoy, and eventually make SOEs retreat from profit-making activities.

Aside from scholars, some eminent public figures have also expressed strong disapproval of a rapidly expanding state sector. Zhang Meiyin (张梅颖), a vice chair of the CPPCC (中国人民政治协商会议), contends that the high incomes that the state monopolies enjoy have become a fundamental source of rising social inequality. She likens the central government SOE to “the irresponsible eldest son who refuses to take care of the poor in the family” and calls for immediate reform for the sake of healthy economic and social development. Bao Yujun (保育钧), head of Research Society for China Non-state (Private) Economy (中国民[私]营经济研究会), notes that over-expansion of the state sector

5 "国有企业性质, 表现与改革", 天则经济研究所课题组, April 12, 2011.  
could suffocate private sector development and undermine entrepreneurship.\(^7\)

It is no surprise that representatives of the private sector have been critical of the *guojin mintui* phenomenon and especially the government’s role in making it to happen. Huang Mengfu (黄孟复), chairman of All-China Federation of Industry and Commerce (中华工商联), an organization that represents non-state entrepreneurs, has criticized the recent expansion of the state sector as “abnormal.” He noted that the Party’s Congress Report for the Fifteenth Party Congress had already stated that state enterprises should get out of competitive industrial sectors in an orderly manner and argued that the recent trend toward *guojin mintui* is against established central policy. Huang warned that government efforts to promote consolidations and mergers around a small number of state-owned enterprises were “unrealistic and would cost dearly in the future.”\(^8\)

The dramatic economic interventions by the American and British governments during the recent global crisis have helped shift the terrain for debate in China. When the two countries that have been particularly well known for their pro-market philosophies rushed to take control of financial institutions and bail out Detroit, it is not surprising that most mainstream economists in China would take a less skeptical attitude toward the more prominent role China’s leadings SOEs have played. They generally share the view that market institutions and a vibrant private sector should be the main force driving development but they also see the necessity of state intervention in a time of global crisis and panic. Fan Gang (樊纲), a former member of the monetary policy committee of the People’s Bank of China and head of a prominent government-affiliated think tank, believes it’s logical that the state sector would expand during a crisis because the state enterprises served as the most effective channel through which the Chinese government directed its stimulus package to the economy and society.\(^9\) For Fan, the state should neither exit completely from the economy nor be in direct competition with the private sector. Instead, it shoulders the

\(^7\) “国进民退不是伪命题 警惕损害市场经济,” 搜狐财经, November 27, 2009,


responsibility of balancing the economy and providing public services.¹⁰

A similar observation is made by Zhou Qiren (周其仁), Professor and Dean of National School of Development at Beijing University and well known for his pro-market leanings. Zhou cautions against a simplistic view of state sector-private sector relations, calling for more careful evaluation on a case-by-case basis.¹¹ For Zhou, there was no conclusive evidence supporting ‘guojin mintui’ because the private sector retained its flexible development capacity and would eventually benefit from the government’s stimulus policies.¹² Some private sectors leaders, such as Zhu Jianghong(朱江洪) and Dong Mingzhu(董明珠), chairman and CEO respectively of Gree (格力集团), the leading home appliance maker, publicly declared that state enterprises are congenitally handicapped in competitive industrial sectors and that a private firm such as Gree would make waves with the gradual withdrawal of government from competitive industries.¹³

Yet even mainstream economists differ on the effects of the government stimulus package and the expanding role of SOEs. Justin Yifu Lin (林毅夫), senior vice president and chief economist of the World Bank contends that the expansion of state-sponsored investment has relatively little crowding-out effect on the private sector because the public investments have tended to go into infrastructure, which the private economy will also benefit from.¹⁴ In contrast, Yao Yang (姚洋), Lin’s former colleague at Beijing University, seems more ambivalent even though Yao was previously known for his more favorable views of the Chinese government’s role. According to Yao, the government’s excessive involvement in an emerging market economy would not only compete against legitimate private interests but also distract the government from the responsibility of providing public services.¹⁵

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For those on the left of the ideological spectrum, however, “the advance of the state” is welcome. Zuo Dapei (左大培), an economist in the Chinese Academy of Social Sciences, also sees it absolutely necessary for a strong, resolute state to assume a central role in directing the economy and protect China core strategic interests.16 On this view, the expansion of the role of government and of the state sector is of paramount national interest in view of the severity of the global crisis.

Yet some on the left have also expressed unease about the expanding role of the state. Cui Zhiyuan (崔之元), a professor of public policy at Tsinghua University, has long criticized liberals' “blind acceptance” of free markets and contend that the free market paradigm has been partly abandoned even in the West. For Cui, the expansion of the public sector is actually part of normal business fluctuations and the nationalization of some private businesses can be justified as correction of market failures—essentially similar to the nationalization of banks during the global crisis.17 Nonetheless, as a self-styled adherent of “liberal socialism”, Cui doesn’t advocate the mindless expansion of the state sector but proposes that effective profit-sharing mechanisms be established to redistribute the monopoly profits state enterprises enjoy back to society.18

More pointedly than Cui, some on the left believe the current Chinese state is already captive to capitalist interests and claim that the investment–oriented government stimulus package favors capital at the expense of the masses. Following this logic, Han Deqiang, a professor at Beihang University, calls for society-wide redistribution schemes to improve the well-being of the citizens.19

Concluding remarks:

In China's rush to stimulate the economy during the recent global economic crisis, many state-owned enterprises were able to

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take advantage of their ready access to credit from the state-dominated financial sector to bulk up and to make acquisitions while firms in the private sector was put on the defensive and, in sectors such as coal and steel, were pressured by local authorities to surrender to government-controlled firms. While economists differ on the actual scale and significance of the state sector’s advance, the guojin mintui phenomenon has nonetheless stimulated a healthy debate. This debate suggests that three decades of liberalization have nurtured a pro-market constituency consisting of influential economists, liberal media, prominent figures in democratic parties, and even some senior government officials. Members of this coalition are sympathetic toward the private enterprises and entrepreneurs and are deeply concerned about the potential reversal of gradual economic liberalization.

The recent debate also carries real policy implications. The Chinese government has responded to the inquiries and concerns about ‘guojin mintui’ in the public sphere with measures intended to correct some of the past policy excesses. In 2010, it issued a new set of guidelines on supporting the development of private investment. Compared with the old 2005 version, the new guidelines take a more proactive tone. Private capital is ‘encouraged’, rather than merely ‘allowed’ to enter state-dominated sectors, including transportation, hydraulic engineering, telecommunication, petroleum production and distribution, and mineral exploration. There is also indication that, partly in response to public criticism, Wang Yong, the newly installed Minister of the State-owned Assets Supervision and Administration Commission, has sought to moderate the aggressive expansion of China’s largest SOEs.

Compared with the rest of the world, the Chinese economy only saw a brief growth slowdown in the global economic crisis and then, fuelled by the government’s massive stimulus package,
quickly moved on to a new phase of post-crisis development. Yet the phenomenon of “guojin mintui” and more generally the proper balance between the public and private sectors remain salient issues in China today. On the one hand, there is much concern that private businesses are being starved of access to loans as the Chinese central bank has tightened credit. On the other hand, large SOEs in telecommunication and petroleum have repeatedly received negative publicity for extravagant decorations, large and unexplained business expenses, and high employee salaries. In a variety of ways the debate on “guojin mintui” was a reflection of the deep structural tensions and imbalances in the Chinese economy. As long as the Chinese state retains its tight grip on the economic commanding heights, the concerns of the guojin mintui debate will stay prominent.
Hong Kong and the Globalization of the Renminbi

Michael F. Martin, Ph.D.¹

Ever since the global financial crisis of 2008, senior Chinese officials have left little doubt that they would like to see the gradual emergence of the renminbi² as a global currency. It is unclear precisely what that means, how quickly this transformation is to take place, and what conditions China’s leadership will place on the globalization of the renminbi. China has already taken several steps to foster greater use of the renminbi in international financial transactions, with Hong Kong playing a pivotal role in these developments. For now, it appears that Hong Kong has been selected as the main test market for China’s policy experiments as it charts a course to make the renminbi into a global currency.

China’s Decision to Globalize the Renminbi

The idea of transforming the renminbi into a global currency has been under consideration by China’s economic policy advisors for at least a decade. However, a globalized renminbi was only one of several options being discussed. Some people supported the idea of creating a regional currency in Asia, similar to the euro. Others thought a global currency that was not tied to any particular nation may be a better model for future. Some tentative steps were taken in Hong Kong between 2004 and 2007 to experiment with offshore renminbi services, but no clear decision was made to pursue the globalization of the renminbi.

China’s attitude seemed to change following the global financial crisis of 2008. The crisis seemed to catch China, and the rest of the world, off guard. Following the crisis, Chinese analysts wrote extensively about the fundamental flaws in the U.S financial system. One such study by the Research Institute of Finance and Banking of the People’s Bank of China (PBOC), China’s central bank, stated, “The current financial crisis originated from the U.S. subprime crisis.”³ The study went on to attribute the severity of the crisis to an over confidence in the self-restraint of market players.

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¹ The views expressed in this article are the author’s alone, and do not reflect the views of the Congressional Research Service, the Library of Congress, or the U.S. Congress.
² China’s currency is called the “renminbi,” or “people’s currency.” It is denominated in units called “yuan.” Some publications use the two terms interchangeably. This article will use renminbi to refer to the currency, except when yuan is used in a direct quote.
inadequate regulation and oversight of financial markets, and inaccurate and pro-cyclical bias in risk assessments.

Chinese officials were also very critical of the current international monetary system and the U.S. role in that system following the financial crisis. Zhou Xiaochuan, Governor of the PBOC, wrote an article in March 2009 suggesting a number of reforms to address the “inherent vulnerabilities and systemic risks in the existing international monetary system.” In the article, Zhou maintained that the “Triffin Dilemma” – i.e., that “the issuing countries of reserve currencies cannot maintain the value of the reserve currencies while providing liquidity to the world” – remains valid. He then argued that consideration should be given to creating a “super-sovereign reserve currency” managed by a global institution. Zhou suggested that the International Monetary Fund’s Special Drawing Right (SDR) could be transformed into such a super-sovereign reserve currency.

While Zhou’s proposal received some international support, the United States rejected the idea. White House spokesman Robert Gibbs told reporters aboard Air Force One, “We've been quite clear that the reserve currency of the world is now and will continue to be the U.S. dollar.”

Even before Zhou’s March 2009 article was released, China had taken some initial steps designed to explore the possibility of making the renminbi a global currency. In December 2008, China’s ruling State Council approved two pilot programs to experiment with cross-border trade settlement in renminbi. One program would allow trade settlement in renminbi for transactions between Guangdong Province and the Changjiang (Yangtze) River Delta in China and the cities of Hong Kong and Macau. A second program would allow trade settlement in renminbi between the Chinese provinces of Guangxi and Yunnan and 10 members of the Association of Southeast Asian Nations (ASEAN). Later on, a third

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5 For example, Russian President Dmitry Medvedev was quoted in the Moscow Times as supporting the creation of a new “super currency” (“Medvedev Talks Up Super Currency,” Moscow Times, April 1, 2009). A UN panel of economists, led by Joseph Stiglitz, also endorsed the creation of a new “Global Reserve System,” based on an expanded role for the SDR (“UN Panel Touts New Global Currency Reserve,” AFP, March 26, 2009).
8 The 10 members of ASEAN are: Brunei, Burma (Myanmar), Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, and Thailand.
trial program was approved that allowed selected Shanghai companies to settle trade transactions in renminbi for larger projects in ASEAN nations, Hong Kong, Macau, and Russia.9

Following the announcement of the pilot programs for trade settlement in renminbi, China rolled out several other trial programs designed to foster the greater use of the renminbi overseas. China negotiated and signed currency swap agreements with several other nations that allowed the settlement of bilateral transactions in the two nation’s respective domestic currencies. The PBOC created new domestic foreign exchange markets, adding such currencies as the Malaysian ringgit and the Russian ruble to the list of foreign currencies offered in Beijing. In addition, China’s State Administration of Foreign Exchange (SAFE) opened options trading for renminbi. Other initiatives introduced to expand the international use of the renminbi included expanding the issuance of offshore renminbi-denominated bonds, permitting the use renminbi to make outward foreign direct investments (FDI), and allowing selected overseas banks to offer renminbi accounts.

In January 2011, SAFE Administrator Yi Gang said, “The overall strategy for the reform of China’s foreign exchange management system is to achieve the convertibility of the yuan on the capital account progressively …”10 Yi also reportedly stated that the renminbi would be convertible on the capital account in five years, or by 2016. Other stories have circulated claiming that Chinese officials had said the goal was to make the renminbi fully convertible by 2015. However, PBOC Governor Zhou has recently stated that there is no timetable for full convertibility of the renminbi – implying that it is a long-term goal.11

Although the decision to globalize the renminbi appeared to have been made, China also took actions that seemed to indicate that it would stop well short of full convertibility for the renminbi. Because of their understanding of the causes and effects of the Asian financial crisis of 1997, China remains very apprehensive about liberalizing capital flows and the potential for causing macroeconomic instability. The global financial crisis of 2008 reinforced that apprehension. China’s leaders are apparently exploring ways to create a globalized renminbi while maintaining prudent capital controls.

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10 “Yuan to be Convertible in Capital Account in 5 Yrs,” China Daily, January 18, 2011.
Why Globalize the Renminbi?

Several reasons have been given for China’s desire to globalize the renminbi. First, China’s leaders have serious doubts that the United States will act as a responsible global citizen when the needs of the international financial system run counter to the preferences of U.S. domestic policy. To Chinese analysts, the Federal Reserve’s decision to push $600 billion into the world economy in November 2010 – the so-called “quantitative easing,” or QE2 – was further proof that China could not rely in the United States. A globalized renminbi would reduce China’s exposure to U.S. policy decisions.

Second, a globalized renminbi would transfer the exchange rate risk inherent in international trade and financial transactions away from Chinese companies and over to foreign companies. Most of international trade and finance is currently denominated in U.S. dollars, forcing Chinese companies to accept the risk of a strengthening or weakening of the renminbi with respect to the U.S. dollar. However, if trade and financial transactions are denominated in renminbi, the Chinese companies no longer must account for exchange rate uncertainty in their international transactions. Similarly, Chinese entities possessing a portfolio of assets denominated in renminbi would no longer risk the erosion of their wealth due to exchange rate changes.

Third, China’s vast holdings of foreign reserves are currently invested in instruments denominated in other currencies, such as the U.S. dollar, the euro, and the Japanese yen. If the renminbi were a widely accepted global currency, there would be less of a need for China to hold its reserves in assets denominated in foreign currencies, reducing the risk of devaluation of those assets relative to the renminbi.

Fourth, global currencies generally do not adjust to other currencies; other currencies adjust to the global currency. By globalizing the renminbi, China would undermine criticisms of its exchange rate policies, and transfer the adjustment process to other nations.

Fifth, China anticipates an elevation in its international prestige if the renminbi becomes a global currency. As a provider of a global currency, other nations would view China as a source of
stability and strength in the world economy, and China’s views of economic policies would have greater influence and importance.

However, a globalized renminbi has its downsides, too. The “Triffin Dilemma” would be just as valid for China as it currently is true for the United States. In addition, China would have to find ways to insulate its domestic economy from rapid and substantial flows of renminbi across its borders, or risk unwanted volatility. The problem of renminbi counterfeiting would likely grow, and with it the cost of policing international financial markets. For now, it seems that benefits outweigh the costs to China’s leaders.

**China’s Campaign to Globalize the Renminbi**

As previously mentioned, China has taken several steps to transform the renminbi into a global currency. Some of these steps are focused on making the renminbi a more readily used currency to conduct international transactions – making the renminbi a “medium of exchange.” Other actions hopefully enhance the renminbi’s reputation as a reliable “store of value.” In addition, China has pressed for more trade to be denominated in yuan so that the renminbi may also serve as an international “unit of account.” Combined, these efforts are designed to make the renminbi a complete international money.

China has introduced a series of financial experiments that have initially focused on making the renminbi a medium of exchange and a unit of account. Subsequently, new initiatives have been announced to foster the renminbi’s use as a store of value, using Hong Kong as the hub for an offshore renminbi capital market. Between 2005 and 2008, China relaxed restrictions on offshore holdings of renminbi by allowing selected Hong Kong banks to offer various forms of renminbi accounts. Following the global financial crisis, China began encouraging trade settlement in renminbi in selective markets and entered into currency swap agreements with other nations. More recently, China had promoted the growth of offshore renminbi assets in Hong Kong, providing a broader portfolio of investment options for overseas holders of renminbi.

One of China’s more advanced steps to increase the acceptability of the renminbi as a medium of exchange for international transactions is its promotion of trade settlements in renminbi. Initially announced by the State Council in December
Hong Kong and the Globalization of the Renminbi

2008 as a limited pilot program, the PBOC has gradually expanded the scope of trade settlement in renminbi to cover all of China. On the other side of the transaction, the PBOC’s focus remains on the 10 ASEAN nations, Hong Kong, and Macau, but businesses in other nations – such as Australia, India, and Russia – have shown interest in settling trade-related transactions in renminbi.

The cross-border renminbi settlement program requires that Chinese enterprises apply with local banking authorities for permission to send and receive renminbi to settle outstanding balances related to international merchandise trade. As of December 2010, nearly 70,000 Chinese companies had registered to participate. The enterprises must also designate a participating domestic bank which has opened a renminbi inter-bank fund transfer account with a participating overseas bank. All renminbi transactions are to flow through the designated domestic and overseas banks and are to be reported to the PBOC.

The first renminbi trade settlement for the pilot program took place on July 6, 2009 when the Shanghai Electric International Economic and Trading Co., Ltd. received payment from its Hong Kong business partner in a transaction involving the Bank of China’s branches in Hong Kong and Shanghai. By the end of 2009, renminbi trade settlements had been conducted in Hong Kong, Macau, and six of the 10 ASEAN nations. According to Hong Kong’s Standard Chartered Bank, cross-border trade settlement in renminbi reached 500 billion yuan ($77 billion) in 2010, or about 2% of China’s total trade. During the first four months of 2011, renminbi trade settlement totaled 530 billion yuan ($82 billion), or about 5% of total trade.

The Chinese press provide fairly optimistic predictions for the future of renminbi cross-border trade settlement. China Daily reported in January 2011 that HSBC’s chief economist in China expected one-third of China’s trade will be settled in renminbi by 2016. In May 2011, Caijing, a Chinese online economic news agency, reported on an HSBC survey of 6,000 companies in 21 economies around the world. According to the HSBC survey, by

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14 The six nations were Brunei, Indonesia, Malaysia, Singapore, Thailand, and Vietnam.
16 Ibid.
the end of 2011, the renminbi will overtake the British pound as the third most frequently used currency for trade settlements, after the U.S. dollar and the euro.

A second and complementary program China has taken to increase the international use of the renminbi is arranging currency swap agreements with other nations. Under a currency swap agreement, the two central banks exchange an agreed amount of their currencies to be used to settle international transactions, thereby avoiding the need to utilize a third currency, such as the U.S. dollar. China’s first currency swap agreement was with the Republic of Korea in December 2008 involving the exchange of the equivalent of 180 billion yuan ($28 billion). Since then, China has entered into currency swap agreements with Argentina, Belarus, Hong Kong, Iceland, Indonesia, Kazakhstan, Malaysia, Mongolia, New Zealand, Singapore, and Uzbekistan (see table).

**China’s Currency Swap Agreements**

<table>
<thead>
<tr>
<th>Partner</th>
<th>Date of Agreement</th>
<th>Value of Swap (billion yuan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>4/2/2009</td>
<td>70.0</td>
</tr>
<tr>
<td>Belarus</td>
<td>3/11/2009</td>
<td>20.0</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>1/20/2009</td>
<td>200.0</td>
</tr>
<tr>
<td>Iceland</td>
<td>6/9/2010</td>
<td>3.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>3/23/2009</td>
<td>100.0</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>6/13/2011</td>
<td>7.0</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2/8/2009</td>
<td>80.0</td>
</tr>
<tr>
<td>Mongolia</td>
<td>5/6/2011</td>
<td>5.0</td>
</tr>
<tr>
<td>New Zealand</td>
<td>4/18/2011</td>
<td>25.0</td>
</tr>
<tr>
<td>Singapore</td>
<td>7/23/2010</td>
<td>150.0</td>
</tr>
<tr>
<td>South Korea</td>
<td>12/12/2008</td>
<td>180.0</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>4/19/2011</td>
<td>0.7</td>
</tr>
</tbody>
</table>

To further enhance the international acceptance of the renminbi as a global currency, the PBOC has also added new onshore foreign exchange markets and will open a renminbi options market. For many years, the PBOC only allowed foreign exchange markets to operate for the British pound, the euro, the Hong Kong dollar, the Japanese yen, and the U.S. dollar. The PBOC opened markets for the Malaysia ringgit in August 2010 and for the Russian ruble in November 2010. However, trade in China’s foreign exchange markets is restricted to approved banks and firms.
seeking to hedge their exposure; speculative purchases are prohibited. In February 2011, the PBOC announced it would open a renminbi options market, subject to similar restrictions against speculation.\textsuperscript{19} A renminbi options market already exists in Hong Kong. The new foreign exchange markets and the renminbi options market provide new ways to convert the renminbi into other currencies.

China has taken other measures to foster greater use of the renminbi in international transactions. On June 21, 2011, the PBOC announced a pilot program for renminbi-denominated inward foreign direct investment by overseas investors.\textsuperscript{20} Prior to the creation of the pilot program, the major channels by which overseas investors could obtain renminbi were trade settlement, bond issuance, and investment as or with a qualified foreign institutional investor (QFII). The pilot program is reportedly designed to provide a new channel for renminbi to flow back into China, and make offshore holdings of renminbi more attractive. Implementing rules and regulations are supposed to be released by the end of 2011.

Efforts are also underway to promote the outward flow of renminbi investments. In January 2011, the PBOC announced a small and selective program to allow certain Chinese enterprises to use renminbi to make overseas direct investments (ODI). To qualify, the enterprise has to be located in an area already approved for renminbi trade settlement. The pilot program is off to a slow start, but Shanghai International Group reportedly is making plans to develop an ODI fund.\textsuperscript{21}

Besides its efforts to make its currency a more attractive “medium of exchange,” the Chinese government had been improving the renminbi’s image as an appealing “store of value.” Many of these efforts involve Hong Kong.

The Role of Hong Kong

Hong Kong has many characteristics that make it a logical choice for China’s experiments with globalizing the renminbi. The city is a long-standing international financial center. Most of the world’s largest banks, including China’s major banks, have

\textsuperscript{19} Kevin Yao and Zhou Xin, “China to Launch Yuan Options Trading,” \textit{China Daily}, February 17, 2011. The restrictions include a ban on put options and a prohibition on exercising the option before maturation.


\textsuperscript{21} “First RMB ODI Fund Established,” Z-Ben Advisors, September 28, 2011.
branches in Hong Kong. Hong Kong’s courts, legal system and accounting services industry provide the necessary support to maintain the city’s reputation as a modern financial hub for global commerce.

Hong Kong’s status as a special administrative region of China also makes the city more attractive as the testing ground for China’s pilot programs for transforming the renminbi into a global currency. Relations between China’s banking authorities – the PBOC, SAFE and the China Banking Regulatory Commission (CBRC) – and Hong Kong’s financial regulators – the Hong Kong Monetary Authority (HKMA), the Hong Kong Exchanges and Clearing Limited (HKEx), and Hong Kong’s Financial Secretary – have grown over the 14 years since the city’s return to Chinese sovereignty. Although Hong Kong is promised autonomy over the supervision and regulation of its financial system in the Basic Law, China’s leaders may believe Hong Kong’s special status may provide them with enough leverage to persuade or influence the city’s financial regulators to accommodate the wishes of Beijing.

The current model for Hong Kong’s role in the globalization of the renminbi appears to be having the city serve as an offshore hub where various forms of renminbi financial services and assets are provided. During his August 2011 visit to Hong Kong, Vice Premier Li Keqiang (commonly thought as the likeliest successor of Premier Wen Jiabao) gave his support to the city’s role as an offshore renminbi center by announcing plans to allow direct renminbi investment from Hong Kong into China. Also while Li was in Hong Kong, China’s Ministry of Finance issued 20 billion yuan of bonds on the Hong Kong market.

By locating these renminbi markets in Hong Kong, the Chinese authorities believe they can insulate the mainland economy from many of the market effects, especially potentially destabilizing capital flows. Special agreements between China and Hong Kong allow the PBOC to control the flow of renminbi across the border – at least in theory – reducing the risk of rapid capital shifts and undesirable inflationary pressures.

The origins of Hong Kong’s emergence as China’s offshore renminbi hub can be traced back to 2001, when Joseph Yam Chi-

22 Chapter V of the Basic Law – or more formally, “The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China” – contains several articles granting Hong Kong the right to establish its own monetary and financial policies, and supervise and regulate its financial markets.
Hong Kong and the Globalization of the Renminbi

kwong, head of the HKMA at the time, proposed to China’s leaders that Hong Kong become a vehicle for increasing the amount of offshore renminbi in circulation. In November 2003, an agreement between the PBOC and the HKMA allowed participating Hong Kong banks to offer renminbi deposit accounts (time and savings), bank cards (debit and credit), remittances and currency conversion. The new renminbi services were phased in early 2004. Through a competitive bidding process, the Bank of China was selected to serve as the first clearing bank for the renminbi transactions.

The new renminbi services proved to be popular in Hong Kong. Renminbi deposits by the end of 2004 exceeded 12 billion yuan, with nearly 280,000 renminbi accounts opened during the year. As of July 2011, renminbi deposits in Hong Kong had reached 572 billion yuan. The equivalent of nearly 15 billion yuan was exchanged in the currency market in 2004, of which about 13 billion involved exchanging Hong Kong dollars into renminbi. Renminbi debit and credit card transactions in Hong Kong in 2004 totaled almost 3 billion yuan. However, the renminbi remittance market was not as popular. Only 263 million yuan was remitted across the border in 2004, with the vast majority flowing from Hong Kong to China.

In January 2007, the PBOC granted permission for renminbi bonds to be issued in Hong Kong. The first offshore renminbi bond – worth a total of 5 billion yuan – was issued between June 27 and July 6, 2007 by China Development Bank CDB). The two-year bond offered a face yield of 3%. The bond was oversubscribed nearly three-fold, with 14 billion yuan in bids submitted. On August 19, 2010, McDonalds became the first multinational corporation to issue a renminbi bond in Hong Kong. The 200 million yuan, three-year bond offered a year of 3%. Since 2007, Hong Kong’s renminbi bond market – nicknamed the “dimsum” bond market – has grown rapidly, with an outstanding bond value of nearly 200 billion yuan ($31 billion).

In July 2009, as previously described, Hong Kong was the first offshore location to process a trade settlement in renminbi (see above). In 2010, banks in Hong Kong handled 370 billion yuan, or 74%, of the renminbi trade settlements.

The next step in the creation of a renminbi asset market in Hong Kong took place in July 2010, when the PBOC and the HKMA

signed the Supplementary Memorandum of Co-operation that allowed non-bank financial institutions (such as securities brokerages and insurance companies), as well as corporations not directly involved in trade with the mainland, to open renminbi accounts and enjoy expanded renminbi services, including loans and payments. This expanded the scope of Hong Kong’s foreign exchange market for renminbi, and gave rise to a new foreign exchange code – CNH – to denote the renminbi in Hong Kong separately from CNY – renminbi in China. The relatively open CNH market allows companies to legally obtain offshore holdings of renminbi either on a spot or futures market. The daily volume on the CNH spot market has risen to $600-700 million.

The creation of the CNH market in Hong Kong has interesting implications for assessing the current “market value” of the renminbi. Since the emergence of the CNH market, the renminbi has generally been stronger (relative to the U.S. dollar) in Hong Kong’s CNH market than in China’s CNY market (see graph). However, the Hong Kong premium has been relatively small and well below trade-based estimates of the alleged undervaluation of the renminbi.

The spring of 2011 gave rise to the first offshore renminbi derivative when Citibank and HSBC offered non-tradable “dimsum” bond indices. In July, Deutsche Bank entered into the “dimsum” bond index market by offering a tradable index.

Source: NASDAQ

To trade in the CNH market, one must have an renminbi account in Hong Kong with an authorized bank.
Another new category of renminbi assets was created on April 11, 2011, when the initial public offering (IPO) of shares in Li Ka-shing’s Hui Xian Real Estate Investment Trust were sold in Hong Kong at an initial offer price of 5.24 yuan per share. To facilitate IPO purchases, Hong Kong banks began offering renminbi promissory notes. The IPO was the first time renminbi-denominated stock shares have been sold outside of China. Perhaps because of Hui Xian’s poor performance since its issuance, no other company has offered a renminbi-denominated IPO since April. However, some companies are reportedly considering providing dual listings of their shares in Hong Kong dollars and renminbi.

One important characteristic of the renminbi markets established in Hong Kong is the care that has been taken to contain and regulate the size and volatility of the asset markets. The PBOC and HKMA have placed some restrictions who can open a renminbi bank account and the size of those accounts. In addition, the PBOC limits the amount of renminbi that can be repatriated. Renminbi remittances are also subject to fairly tight controls. Limits have been set on who can issue renminbi bonds in Hong Kong and who can participate in the CNH market. Similarly, HKEx carefully considers which companies can offer a renminbi IPO.

However, Hong Kong’s financial sector may not be willing to remain confined by the cautious approach taken by the PBOC and China’s other financial regulators. Hong Kong’s commodities market wants to enter the renminbi-based asset market. In September 2011, the Hong Kong Mercantile Exchange (HKMEx) announced plans to start a futures market traded in renminbi for gold, silver and other precious metals. The HKEx is developing plans for renminbi “follow-on offerings” that would allow already listed companies to issue renminbi shares that would be transferable across currencies. The HKMA would also like to develop various renminbi-denominated interest rate derivatives.

Globalization ≠ Full Convertibility

One of the ongoing debates over the viability of China’s efforts to globalize the renminbi is if full convertibility is a necessary condition for global currencies. Some analysts maintain that China must allow the renminbi to be fully convertible in the capital account.

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in order to become a global currency. For example, Nouriel Roubini wrote in an *New York Times* op-ed on May 14, 2009, “At the moment the renminbi is far from ready to achieve reserve currency status. China would first have to ease restrictions on money entering and leaving the country, make its currency fully convertible [emphasis added] for such transactions, continue is its domestic financial reforms, and make its bond markets more liquid.”26 Barry Eichengreen wrote a paper examining the history of the emergence of the U.S. dollar as a global currency, noting that, “In the limit, internationalizing the renminbi means fully opening Chinese financial markets to foreign investors. It means capital account convertibility.”27 However, Eichengreen also notes that the removal of capital account convertibility can and may be one of last restrictions removed by Chinese authorities and is not necessarily a prerequisite for the renminbi to take on some of the attributes of a global currency.

Other analysts maintain that it is possible for the renminbi to become a global currency without full convertibility. Shen Jianguang maps out a plan under which the renminbi can become an international reserve currency by 2015 without full convertibility.28 Shen’s plan calls for a cautious and gradual removal of capital controls, tied with the creation of a strong renminbi market in Hong Kong and the continued reform of China’s financial system, particularly the deregulation of interest rates. Other commentators suggest an alternative strategy under which the renminbi first develops as a regional currency, akin to the euro, serving trade and investment needs in Asia before emerging as a global currency.29

At present, it appears that China’s leaders are following past practices in implementing reforms – introducing modest changes in test markets to determine if to proceed with the reforms and how best to proceed. Hong Kong is playing a pivotal role in China’s current currency experiment. For the medium term, it seems unlikely that the PBOC, CBRC and SAFE will rapidly remove all the existing controls on foreign exchange and capital flows across China’s border. China’s experiences with the Asian Financial Crisis of 1997 and the Global Financial Crisis of 2008 has made it wary of volatile and potentially destabilizing rapid shift in what China views

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as speculative capital flows. In the short term, China will likely focus on promoting the use of the renminbi for trade and investment transactions, while fostering the growth of Hong Kong’s various renminbi asset markets to provide overseas holders of renminbi with a viable, but external place to invest their holdings.

**Implications for China**

Assuming China is successful in transforming the renminbi into a global currency, the nation may reap significant gains, but might also suffer some serious losses. The overall impact of a globalized renminbi on China’s economy is difficult to predict and depends in part on how the rest of the world responds to the emergence of a new global currency – and this particular one.

As previously discussed, China anticipates that a globalized renminbi will reduce its dependence on U.S. economic policy, lower its burden of exchange rate risk, facilitate the diversification of its reserve portfolio, lessen international criticism of its exchange rate policy, and gain in international prestige. A globalized renminbi may also facilitate China’s economic rebalancing, assuming Chinese enterprises no longer perceive an economic advantage in export-oriented production. However, depending on the extent and nature of the renminbi’s acceptability in international financial markets, China could also face some economic challenges.

One of main challenges China’s leaders will have to contend with is the “Triffin dilemma.” As the renminbi grows in acceptance as a global currency, China will have to provide international markets with sufficient liquidity to finance trade, investment and other capital flows. The growing pool of offshore renminbi may undermine faith in the value of China's currency and pose a risk for China’s domestic economic situation. For a period of time, China may be able to mitigate these risks by sustaining strong economic growth and maintaining selective capital controls, but in the longer run, it may prove impossible to maintain the delicate balance.

In addition, a globalized renminbi may force China to alter its current exchange rate policy. As the offshore pool of renminbi grows, the relative importance of the CNH market is likely to rise and dominate the determination of the value of the renminbi relative to other currencies. While it is feasible to argue that the CNY market currently prevails over the CNH market, a time may come when the roles are reversed. Arbitrage and financial capital flows –
legal and illegal – will apply pressure on China’s domestic forex market. China’s options are limited. It could shutdown or intervene in the CNH market, but this could hurt the renminbi’s status as a global currency. Alternatively, it could stop its interventions in the CNY market, but that would create market uncertainty in the renminbi’s value. A globalized renminbi may prove to be the most effective mechanism to make China abandon its current managed float exchange rate regime.

Another challenge that could arise from a globalized renminbi may be increased pressure on China’s various capital controls. For several years, the PBOC and SAFE have been trying to stem the inflow of "hot money," foreign exchange entering China that cannot be attributed to net trade surpluses or inward FDI. As the offshore volume of renminbi increases, it is reasonable to expect the desire to utilize the renminbi inside China to rise. Depending on the perceived potential gain from the possible domestic uses of the renminbi, PBOC and SAFE may have to contend with even greater “hot money” flows. While more stringent enforcement of capital controls might work, China may also decide to lower its capital controls and cope with potential instability.

Possibly the more difficult challenge would be if China is only partially successful in transforming the renminbi into a global currency. If its efforts result in a renminbi that is acceptable only for certain transactional purposes with selected Asian nations, China would receive few of the benefits of a globalized currency, and at the same time, have to contend with some of the challenges discussed above. This may explain in part why China is being particularly cautious in advancing the globalization of the renminbi in a gradual and controlled fashion.

Implications for Hong Kong

Hong Kong may undergo the most dramatic changes and face the most serious challenge if the renminbi is transformed into a global currency. The Hong Kong economy may become more dependent on its financial sector for prosperity and growth, with significant implications for its work force. At some future date, the Hong Kong dollar may be de-linked from the U.S. dollar and re-linked to the renminbi as China’s role in Hong Kong’s economic fortunes rise. The conceptual and practical distinction between the Chinese mainland and Hong Kong may fade, and the Hong Kong dollar may disappear. While in the short run, Hong Kong stands to
gain from the globalization of the renminbi, the long term costs may prove to be very high.

Hong Kong has been a service economy for over 20 years. The services sector provides over 90% of the city's gross domestic product (GDP). Over the last decade, the financial sector has increased its contribution to Hong Kong's GDP from 11.9% to 15.2%. Assuming Hong Kong remains the offshore hub for the promotion of a globalized renminbi, it is likely that Hong Kong's financial sector will experience rapid growth and become a more important segment of the city's economy. While this will foster growth and generate wealth, it will probably also contribute to Hong Kong's rising income and wealth disparities, which have already been identified as a serious social issue.

It is also unlikely that Hong Kong’s financial sector will generate sufficient employment to absorb the city’s youth seeking employment. Hong Kong is already experiencing problems generating jobs for its college graduates. According to recent research by Professor Michael DeGolyer, Hong Kong’s youth are increasingly disaffected and the city’s students are being radicalized in part because of a perceived lack of economic opportunity in Hong Kong. An economy more reliant on financial services will not provide sufficient well paid jobs for Hong Kong’s youth, and may force younger Hong Kong residents to either emigrate or accept lower paying positions in other sectors, such as retail, food service, and tourism.

As Hong Kong’s economy becomes more reliant on China, it may become more rationale for the Hong Kong dollar to be linked to the renminbi rather than the U.S. dollar. In 1983, Hong Kong adopted a currency board system, linking the Hong Kong dollar to the U.S. dollar at a fixed exchange rate of 7.8 to 1. At the time, the link with the U.S. dollar was desirable because it was the preeminent global currency and Hong Kong’s economy was largely dependent on international trade, which was denominated and conducted in U.S. dollars. If the renminbi becomes the unit of account and settlement for trade in Asia, the HKMA and the Hong Kong government may decide to shift the link from the U.S. dollar to the renminbi. Chief Executive Donald Tsang Yam-kuen has indicated that such a shift may be possible on an unspecified future date. Over time, Hong Kong may even consider the elimination of the Hong Kong dollar, as the amount of renminbi in circulation in

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30 Data from Hong Kong’s Census and Statistics Department.
Hong Kong rises and its becomes a generally accepted currency. The renminbi is already generally accepted in Hong Kong for retail transactions.

The emergence of the renminbi as a global currency may serve as another factor blurring the distinction between the Chinese mainland and Hong Kong. Hong Kong’s economy is already showing signs of the growing influence of Chinese capital, Chinese companies, and Chinese workers. A rising share of HKEx’s listed companies are subsidiaries of Chinese companies; the Hang Seng Index includes many Chinese companies jointly listed in Hong Kong and Shanghai or Shenzhen. Hong Kong’s executive work force includes many more Chinese nationals than it did in 1997. It is feasible – but not inevitable – that for all practical purposes, Hong Kong may become indistinguishable from major mainland cities in the not too distant future.

Implications for the United States and the Rest of the World

The United States and the U.S. dollar are not currently threatened by China’s effort to promote the renminbi as a global currency, and may not ever be threatened. To a limited extent, the British pound, the euro, and the Japanese yen are global currencies, but none of them can challenge the dominance of the U.S. dollar. The renminbi, however, could compete with the U.S. dollar as the global currency of choice if the United States fails to take sufficient steps to bolster its economy and reinforce the global image of the U.S. dollar.

One possible scenario for the future is a “three-legged” financial system in which the Chinese renminbi, the euro, and the U.S. dollar serve as global currencies, with each currency dominating a regionally-based sphere of influence. In a May 2010 interview, Joseph Yam said, “In the long run, the global monetary system may need a third leg, or the third pillar, to bring about stability.”

China’s leaders may have such a scenario in mind, and are actively promoting the creation of a pan-Asian free trade zone and Asian economic integration via such mechanisms as the ASEAN+3 model. In this light, the United State’s focus on the Trans-Pacific Partnership negotiations may be viewed as an alternative to China’s model for the global economy.

The Functions of Money

The professor for my undergraduate course in money and banking at Michigan State University liked to present the three main functions of money in this order: Medium of exchange; Store of value, and Unit of Account – or MSU – to make it easy to remember.

As a medium of exchange, an object serving as money allows transaction to occur even when there is no coincidence of wants. In a barter exchange, both parties must want or desire the object offered by the other party. Through the intermediation of money, that is no longer necessary. However, both parties must believe that the money object can be used in subsequent exchanges.

As a store of value, an object functioning as money must be able to retain value over time. Many commodities lose value over time due to rot or decay. In theory, money doesn’t lose value over time. However, inflation and changes in exchange rates may erode the value of money holdings. For this reason, central bankers are often very concerned about inflation and exchange rate volatility.

Finally, as a unit of account, money creates one way to directly compare dissimilar objects, especially for exchanges. There are many ways to compare dissimilar objects – which one is taller, heavier, rounder, prettier, etc. However, the translation of an object into a specific amount of money provides people with a sense of its worth, particularly when compared to other objects.

A global currency needs to perform all three of the functions of money irrespective of international borders. People across the world must be willing to accept the global currency in exchanges, be confident that its value will be preserved over time, and have a sense of an object’s worth when expressed in the units of the global currency. No currency performs all three functions perfectly, which contributes to development of foreign exchange markets and their related derivatives markets.

Reviewed by Robert L. Worden

Former Assistant to the President for National Security Affairs and former Secretary of State Henry Kissinger has written numerous books on statecraft and foreign policy. While much of his writing has touched on China as part of the greater scheme of global affairs, this book is exclusively on China. It is based in part—an important part—on conversations the author held over the years with top Chinese leaders, in Beijing, Shanghai, Washington, New York, and elsewhere. The author points out that a primary focus of the book is on the interactions since 1949 between the leaders of the People’s Republic of China and the United States, including four generations of China’s leadership (Mao Zedong to Hu Jintao) and eight U.S. presidents (Harry Truman to George H.W. Bush). Kissinger himself was privy to numerous first-hand conversations, on which he kept notes, with such Chinese luminaries as Mao, Zhou Enlai, Hua Guofeng, Deng Xiaoping, Zhao Ziyang, Jiang Zemin, Hu Jintao, and Wen Jiabao and their supporting casts of military officials, government bureaucrats, and party cadre. Of course, he also counseled the Republican U.S. presidents he served or advised, from Nixon to Bush and also has those first-hand accounts to add to the book. No single person has had such long-term, intimate access to such an assemblage of Chinese and American leaders and this alone makes *On China* an important book.

*On China* is much more than a personal reminiscence and, although it is not a biography, one might wish for even more first-hand observations and expressions of opinion than the many that are offered. Nevertheless, Kissinger, aided by his research associate, Schuyler Schouten, who translated Chinese-language texts and helped interpret the subtle implications of Chinese diplomatic and political parlance, has written a tour d’horizon of China’s foreign policy and diplomatic history. He begins with the ancient imperial era, when international relations were based on China’s preeminence as the Middle Kingdom. The “singularity of China” is thus addressed in the opening chapter, which discusses the foreign-policy roles of Confucius and Sun Tzu’s Art of War. In the following millennia, China “was never engaged in sustained
contact with another country on the basis of equality for the simple reason that it never encountered societies of comparable culture of magnitude,” writes Kissinger. In the second chapter, the author moves quickly to the late 18th and early 19th centuries, with the early foreign diplomatic missions to China, the Opium War, and the period when a weakened Beijing’s perceptions were based on “soothing the barbarian.” Chapter 3 analyzes China’s national decline, the regime’s response to the West, internal strife, war with Japan in 1894–95, and the Boxer Uprising in 1901. The rest of the book, except for the closing chapter that focuses on the new millennium, is devoted to the momentous events of the twentieth century.

The main core of the book is devoted to the 1949–2000 period. A chapter on Mao’s continuous revolution and his approaches to foreign policy is followed by a chapter on the emerging Cold War and the hot Korean War and confrontation with the United States. Successive chapters deal with Beijing’s emerging confrontations with both the United States and the Soviet Union, war with India, and the Cultural Revolution. At the end of chapter 7, Kissinger poses the question whether or not the rapprochement between the United States and China in the early 1970s might not have occurred a decade earlier. He points out Senator John F. Kennedy’s 1957 Foreign Affairs article in which the future president counseled against maintaining a “strait-jacket” China policy which could cause the United States to fail to detect favorable changes when they arose.

As it turned out, the changes that Mao rendered were not favorable. The Anti-Rightist Campaign, the second Taiwan Straits crisis, and the Great Leap Forward were all launched and hostility to the United States and, soon, the Soviet Union, was paramount. Despite these unfavorable situations, plus a border war with India, the Kennedy administration offered humanitarian aid to China, which was rejected in favor of Mao’s “self-reliance.” The Johnson administration sought a less confrontational policy toward China just at the time Mao and his cohorts launched the Cultural Revolution in 1966 and began a retreat from the world stage. Nevertheless, as behind-the-scenes bilateral Geneva and Warsaw talks continued, the “road to reconciliation,” as Kissinger puts it, began with new Chinese and American strategies (including Mao’s willingness to invite a U.S. mission to visit China and Richard Nixon’s acceptance) and armed clashes with Soviet forces on their shared border. Kissinger calls the initial steps of rapprochement
with China, including his 1971 secret meetings with Zhou Enlai, as “the most dramatic event of the Nixon presidency.”

After the 1972 Nixon visit, Kissinger had four subsequent meetings with Mao in 1973 and 1975, to which the better parts of two chapters are devoted. The Zhou-Kissinger meetings also are closely analyzed, especially in light of Zhou’s eclipse as a foreign policy player in early 1974 and the simultaneous rise of Deng Xiaoping and the emergence of economic reforms in China and a new era in U.S.-China relations. The rest of the book covers the Deng and Jiang Zemin governments and the ups-and-downs of U.S.-China relations in the post-Cold War era. The final chapter, on relations in the new millennium, discusses the new generations of leaders in both countries and their perceptions of current realities and historical preludes. Of special interest is the analysis of China’s internal debates about its place in the globalized world. As an epilogue, Dr. Kissinger offers a comparison of contemporary U.S.-China relations with the rivalry that existed 100 years earlier between Britain and Germany, posing the question: “does history repeat itself?”
Reviewed by Diana Sweet

China Goes to Sea is a must-read for those interested in gaining a strong foundation to understanding the Chinese navy. The edited volume works diligently to provide a strong comparative historical framework to analyze and comprehend the vicissitudes of China's navy. It is an ambitious work that begins with the pre-modern era and touches on so many relevant issues to current day naval might. It is sure to inform the amateurs who know little beyond Zheng He's voyages of the 15th century to the experts who have yet to contemplate the lessons that can be learned from histories of fallen ancient empires. Erickson, Goldstein and Lord break up their work into sections that alone are worthy to be published. Organization of the book takes a look in turn at the pre-modern era, the modern era, Chinese maritime transformations and China in comparative perspective.

For the pre-modern era, contributors reflect upon the naval experiences of Persia, Sparta, Rome and the Ottomans. In the volume's penultimate chapter, Carnes Lord claims that of all attempted naval transformation, the only two to ever successfully do so were Persia and Rome. Speaking more to the exceptional circumstances of naval transformation, Gilbert describes the unique method through which Persia was able to do so with such rapidity. Specifically, it was the strong and strategic leadership that made use of the maritime provinces for manning the crews of the Persian fleets, making it only a matter of building the ships, not training the nation. The volume covers the modern era by looking at the experiences of imperial French, Russian and German cases in addition to Soviet Russia. While these experiences leave the reader with a negative impression, the exceptional case of China, while not immune from some of the tragic fate that befell a few of the aforementioned powers, has convinced some of these authors that it may have what it takes for true naval transformation. The editors also put together a section that focuses on the changes that have taken place within the Chinese state in the sphere of naval development. Andrew Wilson characterizes the Ming dynasty as an overall decline and change in strategy following the final voyage of Zheng He, specifically one of transition from an aggressive
maritime to a defensive continental focus. This change in strategy had long-term effects that were made apparent by the Chinese navy’s ineffectiveness against Western counterparts during the Qing era, as Elleman reports that there were no dynastic policies that required a robust navy. Later in the section Cole provides readers with an interesting take on Chinese naval power during the cold war and certain explanations for why it took the communist regime thirty years to recognize the strategic importance to a strong naval force.

The final section works to pull all earlier aspects of the book together and place the experience of the Chinese navy in a comparative perspective. As expected, much of this section focuses on economic and regional incentives and opportunities for China to rise as a strong sea power. Collins and Grubb explain some of the inner workings of the Chinese shipbuilding sector and argue that China’s ability to rise again as a major sea power is directly related to its commercial shipbuilding developments which have seen vast improvement over the last thirty years. Strongly linked to the aspect of commercial shipbuilding is the international economic market, which has allowed China to grow and challenge other naval powers in a rather non-traditional front. Further speaking to China’s ambitions, editors Erickson and Goldstein present selected conclusions from a recent Chinese study done on the Rise of Great Nations, a study that drew its inspiration from a presidential directive to determine what factors lead to the most rapid and benevolent development. This chapter in particular provides readers with an interesting, albeit select, window into a Chinese perspective of development and rise of power.

While the book does an impressive job at a very ambitious goal, it may have helped to enlighten its audience on the rationale behind the historical cases chosen as an argument can be made that significant naval forces throughout history are curiously absent from the volume. Moreover, a point that could be further analyzed would be the varying degrees of significance naval power represents in modern nations and regions. The editors make note in the preface of how many Western nations, the United States included, have been emphasizing naval power less and less both in talk and in funding while many Asian nations have begun to focus a lot of manpower and finances in exactly that realm. There is a strong argument made by some academics and politicians that power and politics greatly depend on symbols. While this normative idea does not resonate everywhere it does seem as though the
editors of this volume believe in its merits and as such further delving into the matter could lead to an interesting perspective of the significance of naval power as a modern symbol.

As details continue to emerge on China’s refurbishment of a former Soviet aircraft carrier and other extraordinary developments of the People’s Liberation Army Navy (PLAN), this volume offers a wealth of knowledge and history meant to help determine possible future strengths, weaknesses and potential trajectories. Readers will notice the importance and continuous debate about whether China is a maritime, continental or maritime-continental power. This theme is repeated through the pages of the volume and China’s self-perception of its land and/or sea prowess and ambitions will be interesting to follow in the years and decades to come. *China Goes to Sea* represents a new and fresh lens through which to understand the plan and is a welcome addition to any scholar or enthusiast’s library.

Reviewed by Robert L. Worden

Andrew Erickson and Lyle Goldstein of the U.S. Naval War College’s Strategic Research Department have teamed up for the fifth time to produce an excellent addition to their series on China’s maritime development. Earlier books in the series covered the historical perspective on maritime development, the nuclear submarine force, the impact of energy strategy on maritime policy, and a comparison of Chinese and U.S. sea power in the twenty-first century. This time they and their contributors address the emerging importance of China’s maritime aerospace role. The book is timely given China’s successes in its space program and the recent announcement of its first aircraft carrier’s maiden sea trial. The contributors include other Naval War College and university professors, senior intelligence officers, active duty and retired military officers, and public-policy and think-tank analysts, among others. Technical U.S. Air Force and Navy operators and regional area specialists, many of whom presented papers delivered at a December 2008 conference on China’s aerospace power that evolved into this book, also wrote chapters.

According to the foreword, the chapters are aimed at addressing the realities of the People’s Liberation Army and its navy “as a modern, complex military” and are intended to provide “a broad and objective assessment of Chinese aerospace and maritime power by professional researchers.” Goldstein’s introduction promises “substantial new insights” to the question on China’s national security policy vis-à-vis the new aircraft carrier while at the same time offering a much broader scope of analysis.

*Chinese Aerospace Power* is divided into six thematic sections: Chinese Aerospace Development: Emerging Maritime Roles; Chinese ISR [intelligence, surveillance, and reconnaissance] and Counter-ISR; Contrasting Strategies: Protecting Bastions or Projecting Power?; Maritime Strike: Air-Launched Cruise Missiles; Maritime Strike: Ballistic Missiles; and Maritime Implications of Chinese Aerospace Power. Each section has between four and six chapters, of which there are 27 altogether. The importance of this book is highlighted by chapters such as those covering the long-range challenges of China’s aerospace revolution, the regional
marine implications of modernization, space doctrine, airborne antisubmarine capabilities, sea-based air power, cruise missile developments, the ongoing role of the PLA Second Artillery Corps, antiship missile capabilities, and integrating these and other maritime aerospace capabilities into Chinese strategy and doctrine.

Rounding out the book is a well-documented appendix, a list of acronyms used in the book, brief information on the 33 contributors and two editors (who also authored or co-authored the introduction and four of the chapters), and a substantive index. The appendix, entitled “China’s Military Aerospace Forces: A Visual Overview,” features world maps showing striking distances of China’s medium- and intercontinental-range ballistic missiles and distances of China’s conventional-force strike projections, and a China coast map indicating the ranges of short-range ballistic missiles and surface-to-air missiles targeting Taiwan and the ocean beyond. A fourth map shows the location of China’s naval and air force headquarters and the locations of major fighter, bomber, and transport units. Two tables list the numbers, types, and ranges of China’s ballistic and cruise missile inventories and the air military balance between China and Taiwan. As suggested by the partial list of chapter topics mentioned above, Erickson, Goldstein, and their team offer a substantial overview of China’s maritime aerospace developments, with a focus on important strategic areas, some of which are receiving notice for the first time. This makes the book important reading for military practitioners and government and policy analysts who follow China’s rise to great-power status.
A TIMELY WORK FOR READERS INTERESTED IN CHINA

From the author, a professor of Chinese history and U.S.-China relations for the past 40 years, comes the story of his childhood as a student in pre-revolutionary China, his journey to America after the 1949 Communist Revolution, and his pursuit of a new life, education, and career in our nation's capital for the past half-century.

A COMPELLING JOURNEY
FROM PEKING TO WASHINGTON
BUILDING A NEW LIFE IN AMERICA

CHI WANG

This coming-of age tale offers a personal and political history of China, weaving in events and prominent figures from the 1930s onward. The author presents an intimate eye-witness account of life in China before 1949, and an uncommon perspective as a Chinese emigrant in D.C. for 60 years. Truly a unique piece for students of history, policy, and the ever evolving U.S.-China relationship.

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