



U.S.-China Relations: Changes & Opportunities

Fifth Annual Barnett-Oksenberg Lecture

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I am deeply honored to be invited here this evening to deliver the fifth Barnett Oksenberg Memorial lecture jointly organized by the Shanghai Association of American Studies and the National Committee on U.S.-China Relations. I want to thank a number of organizations and individuals who have made this wonderful event possible, including.

The organizations and the illustrious list of sponsors that you see listed behind me and in your brochure;

Paul Liu for being the spark that initiated this lecture series as a means to honor Doak Barnett and Michael Oksenberg, two teachers who were most important to him.

Professor Ding Shinghao for his very gracious introduction and for his work along with that of Paul and Jan Berris to coordinate the many organizational details, and

The American Chamber of Commerce in Shanghai for its magnificent logistical assistance.

I had the enormous pleasure of knowing both Professors Barnett and Oksenberg, widely acknowledged as two of America's finest China scholars.

In the '80s when Doak Barnett was a scholar at the Brookings Institution, I served as a member of the Brookings' board of trustees and was much impressed with his book China's Economy in Global Prospective published by Brookings. In the early 1990s our paths crossed at meetings of the National Committee on US-China Relations, an organization that he was instrumental in founding and where he served as its first Chairman. His knowledge of China was deep and broad as was his generosity of spirit.

Michel Oksenberg and I became friends serving as board members of the National Committee and attending events hosted by the Council on Foreign Relations and the Trilateral Commission. His humor and grace made him loved by all who knew him. Many of the observations he made in his book Shaping US-China Relations: A Long-Term Strategy could be usefully applied today.

Both men moved easily in the worlds of academia and politics. During his lifetime, beginning with Lyndon Johnson, Doak advised every Administration about China and the importance of establishing and maintaining a constructive bilateral relationship. He is believed by many to have been one of the voices influencing President Nixon to make the overtures to China that led



to the signing in 1972 of the Shanghai Communiqué and paved the way to restoring diplomatic relations.

Mike served in the National Security Administration under Zbigniew Brzezinski during the Carter Administration and was a member of the delegation that traveled to China for the signing on January 1, 1979 of the Joint Communiqué on the Establishment of Diplomatic Relations.

Both men believed in comprehensive engagement and urged patience and understanding in pursuing solutions to tough problems. In the intervening years, the Sino-American relationship has deepened and broadened in ways few could have imagined in those early days.

However, all of us who care deeply about the bilateral relationship are concerned by the unexpected friction that has surfaced in recent months. Some of the friction is a natural result of the fact that the relatively clear-cut bi-polar challenges of the Cold War have been replaced by new, complex 21st Century transnational challenges like the global economic turmoil, nuclear proliferation, pandemics, terrorism, drug trafficking and climate change, and involve many more players.

But another factor complicates our interactions. At times it appears that our respective governments have an insufficient understanding of the political pressures or the competing interests driving the other side. That makes it more difficult to figure out how to bridge our policy differences. We need to talk more to achieve a better understanding.

China has become much stronger economically, geopolitically, and militarily. For three decades it has averaged double digit growth. Last year in the midst of a global recession China grew by close to 9 percent maintaining its position as the world's fastest growing economy. This year China is likely to replace Japan as the world's second largest economy and its largest trading nation.

Increasingly the questions are posed. Can the world's largest and fastest growing economies constructively work together to enhance our future prosperity and stability? Or have our increasingly competitive economies along with the differences in our histories, forms of government, and domestic sensitivities become too great to enable us to harness our respective strengths to deal effectively with today's bilateral and global challenges?

Like the men we honor tonight, I am an optimist. I believe we can, should, and must work constructively together, and more importantly I believe that by doing so we can build habits of cooperation that will help us deal effectively with new challenges as they arise, which will not only enhance the wellbeing of the people of China and the United States but will contribute meaningfully to global peace and stability.



Topics to be discussed

Initially when I was invited to speak, given my interests and background, I intended to focus my remarks on the economic challenges and opportunities affecting our relationship rather than on foreign policy or security issues. But the disagreements that have arisen recently over basic foreign policy issues inevitably affect how we will deal with economic issues.

For that reason I have broadened the scope of my remarks. I have been advised to be candid, and I will be to better explain how important it is for both sides to take steps to moderate these frictions.

Let me start by assessing policy differences that have existed over a number of years that recently have become much more rancorous.

Long Standing Disputes

Take the February 2 announcement that President Obama would meet with the Dalai Lama, a decision that was communicated to the Chinese leadership before the announcement. Every sitting U.S. President over the past two decades has met with the Dalai Lama. China has consistently expressed its disapproval, but Americans were quite frankly astonished by China's unprecedented level of anger regarding President Obama's decision to meet.

Our differing views of the meeting are undoubtedly shaped by our different values, cultures, and politics. For the Chinese the Dalai Lama symbolizes the tensions in Tibet that it sees as a challenge to its national unity. For Americans the Dalai Lama is a respected international religious leader. When Presidents meet unofficially with such individuals, the meeting symbolizes the religious openness that is so basic to our culture. A refusal to meet would have subjected President Obama to harsh criticism from Americans of all political persuasions.

Again, last month's announced arms sale by the United States to Taiwan generated an outburst of anger by China that took most Americans by surprise.

Every Administration since the 1979 normalization of U.S.-China relations has sold arms to Taiwan pursuant to the Taiwan Relations Act, which was signed four months after our two governments normalized our diplomatic relations. In that Act Congress required the United States "to provide Taiwan with arms of a defensive character."

As with the meeting with the Dalai Lama, the Obama Administration advised China before it was publicly announced that it would implement an arms sale agreement reached in 2008 to sell \$6.4 billion arms to Taiwan which included interceptor missiles, helicopters, and communications equipment but not the requested F-16s. The President would have paid a high political cost had he refused to move forward with the agreement.



In its anger China threatened sanctions against the companies selling the products and the withdrawal of cooperation on international issues.

It is especially regrettable that it also suspended planned high level military exchanges and postponed the agreed visit later this year by U.S. Defense Secretary Gates as well as scheduled talks between Chen Bingde, the Chinese Peoples Liberation Army Chief of General Staff and Admiral Michael Mullen, the Chairman of the U.S. Joint Chiefs of Staff.

Where our two governments have disagreements over matters of defense, it is particularly important for our military leaders to meet and discuss those differences. That is not happening today.

A habit of regularly holding such meetings might well have moderated the rancor over the arms sales to Taiwan.

Most experts, both Chinese and Americans, believe that trust between our military forces is much lower than exists in other areas of our relationship. The number and level of our joint military exchanges lags far behind the number and level exchanges our two governments have established to discuss economic and other policy issues.

This weakness of our military relationships was acknowledged at the July Strategic and Economic Dialogue where both sides agreed that additional such exchanges should occur. It was again recognized during the Obama-Hu meeting this past November where the two Presidents agreed in their joint statement to “actively implement various [military] exchanges . . . increasing the level and frequency . . . to foster greater understanding of each others intentions and of the international security environment.”

Our military leaders may continue to disagree on issues. But regular and candid face-to-face discussions could help explain the reasons for actions taken by each side, reduce the possibilities for miscalculation, and provide a forum in which to try to resolve misunderstandings. Rather than wait for crises to develop, we should find ways to prevent them.

One way forward might be to create a Strategic Military Dialogue to bring together our military leaders on a regular basis to talk about issues like Taiwan. In that case perhaps they might reach an agreement that could see the Chinese reducing or pulling back the number of missiles in Fujian pointed at Taiwan and the Americans reducing or downgrading future sales of defensive weapons to Taiwan.

As a policy backdrop, one cannot help but notice and be pleased that in recent years Taiwan and China have built much stronger economic bonds. President Ma Ying-jeou has been a persuasive voice for increasing social and economic interactions across the Strait. He has been an advocate



for the Economic Cooperation Framework Agreement which would reduce bilateral tariffs and increase trade opportunities between Taiwan and the Mainland. He has also sought to reduce domestic political friction with his declaration of “no independence, no unification, and no use of force.”

Some Americans who study Taiwan politics closely believe that had the United States reneged on its arms sales agreement, that fact would have been used against President Ma by his political opponents who oppose the recent warming of cross-strait relations and continue to agitate for independence.

The United States and China both share an interest in the harmonious cross Strait relations that President Ma supports. With regularly held dialogues our military leaders could share their assessments of the political setting in which decisions involving defense are made. Such exchanges are likely to reduce friction even where views are not the same.

Equally puzzling to Americans was China’s threat to withdraw cooperation with respect to unrelated international issues, such as the development of nuclear weapons in North Korea and Iran.

Although neither the United States nor China want North Korea or Iran to become nuclear powers, China assesses both threats as lower than does the United States. Our different assessments of the risks further underscore the need for and the value of increasing the number and frequency of joint military dialogues.

With respect to North Korea it is well known that it has developed and tested a nuclear bomb, built a reactor in Syria, and has sent component chemicals to Libya. Many defense experts in the United States believe that North Korea’s greatest threat is its willingness to export nuclear bombs, material, or technology for cash.

China is best situated to discover any attempt by North Korea to ship a nuclear product to the Middle East, which would create a major global risk. To reduce that risk, our two governments should be working together with Japan, Russia, South Korea, members of the 6-party talks, to obtain North Korea’s agreement on what has been called the three “Nos”

No exports of nuclear weapons or materials;

No building of additional bombs; and

No more testing, which could advance North Korea’s ability to build better bombs.

The international community, including the United States, is also highly concerned about Iran’s nuclear enrichment program. Iran claims that it is enriching uranium for fuel but has failed to respond to a proposal from the five permanent members of the U.N. Security Council, which includes both China and the United States, to swap Iran’s low-enriched uranium for processed



nuclear fuels. Iran's development of a nuclear weapon would be enormously destabilizing in the Middle East.

Cooperation between our governments and our respective militaries to limit the nuclear ambitions of North Korea or Iran is not a favor that China grants the United States, but rather a global challenge that must met by the exercise of global leadership.

I am concerned that China's highly publicized threat to refuse to cooperate with the United States to find effective solutions for international challenges because of unresolved bilateral disputes puts at risk not only China's reputation as a global problem solver but also the world's prospects for future peace and stability.

We will continue to have strategic and foreign policy issues where we do not agree. But we should talk about them candidly, listen carefully, and try hard to bridge the gaps.

Economic Issues

And that applies equally to economic issues. We share interests in a number of serious economic challenges; two the most critical today being the need to rebalance the global economy and the need to keep global markets open in the face of mounting economic nationalism.

Rebalancing the Global Economy

Take the enormous problems created by the serious imbalance in the global economy. It has grown over the years because China, Germany, Japan and other Asian economies have built their growth on exports, whereas the United States, the United Kingdom and Spain have relied excessively upon domestic consumption, particularly in the housing sector, to fuel economic growth.

Although investment excesses in the financial sector triggered the fiscal crisis in 2008, there is general agreement that the global imbalances made the crisis much worse. As stated last year by Gerald Corrigan former President of the New York Federal Reserve: "It is highly likely that these imbalances would create a serious macroeconomic problem even if we had not had the fiscal problem."

If we are to protect against future global financial crises, the global economy must be brought into better balance. That will require debtor and creditor nations to alter their existing economic models to put their economies on a more sustainable growth plan.

Debtor nations cannot continue to consume at the excessive levels of the past, and creditor nations must look more to their own consumers to fuel their economic growth.

That means that the United States must stop its consumption binge and reduce its soaring deficit fueled by excessive government and household spending. And China will need to reduce its



reliance on exports and investments, particularly in heavy industry, as its principle sources of its growth.

A commitment by the United States to undertake structural reform necessary to achieve more balanced growth is not a favor granted to China; nor is a decision by China to stimulate its domestic consumption a favor the United States. The policy corrections that each needs to make are necessary to ensure each nation's future financial stability and prosperity, for if corrections are not made, the global imbalance will likely ignite another economic crisis.

Global balance is more likely to be restored if the world's largest debtor nation and its largest surplus nation take the lead in implementing corrective measures.

While necessary, these changes will not be politically popular. But having the United States and China take corrective action in a similar time frame is likely to reduce the political friction in both countries.

We all know that the necessary policy changes cannot be implemented overnight. But if each of our governments were to commit to specific structural reforms, spell out the particular steps that each would take with time frames where appropriate, and provide periodic updates regarding their progress (perhaps at meetings of the G-20), that would boost confidence in the future health and stability of the global market, which in turn would help keep our respective domestic economies on a sustainable growth path.

In the United States that means that both the private and the public sectors will have to curtail their spending and increase their savings. In response to the crisis the private sector has increased savings by 5 percent. But the federal government's budget outlays have risen by 5 percent thus offsetting all of the increase in private savings.

Going forward the United States government needs to commit to bring its primary budget into balance in a specified period like 5 years and its overall deficit into balance in a specified period like 10 years. It must reinstitute a pay as-you-go-program enforced by a process that limits future unfunded spending and requires any gaps to be filled by new tax initiatives. It will also need to restructure entitlement programs like social security to take account of longer life spans. The political response to these changes will be highly unpopular, but it will protect Americans from what could be an even more serious recession in the future.

Going forward China's government has a number of policy instruments to encourage an increase in domestic consumption to fuel its future economic growth. As Doctors Lardy and Goldstein document in their well written study entitled The Future of China's Exchange Rate Policy, fiscal, financial, exchange rate, and price are four policy instruments that China could use to reduce preferences now given large companies that invest in heavy industry and manufactured goods for export.



For example, correcting China's under-pricing of land, energy (electricity and fuel), capital, and water would discourage excessive investment in heavy industries like iron and steel that rely on those production factors. More equitable pricing of those factors, particularly capital, would encourage the development of small and mid-size enterprises that are the backbone of job creation, which in turn would help moderate the wage gap between urban and rural workers.

Using fiscal, financial, exchange rate, and price instruments to reduce China's reliance on heavy industry and exports is likely to be opposed by the interests who benefit from the system as it is. But changing the system would greatly benefit the Chinese people. Yet many in China are unaware of what is at stake.

It is a surprise to many Chinese that the five most intensive energy industries in China account for over 40 percent of its energy demand, create most of the pollution, and yet employ fewer than 2 percent of China's work force. According to a 2006 report of China's Environmental Protection Agency the cost of environmental degradation costs China between 8 and 13 percent of its GDP, causes 750,000 deaths each year, is responsible for China's chronic shortage of clean water, and has resulted in soil pollution that has destroyed thousands of acres of arable farm land.

In short our two governments by taking on this challenge of rebalancing their respective economies could turn it into an opportunity to deliver very substantial benefits to their respective populations. Also they would gain the addition benefit of helping to correct the global imbalance, a major factor in creating the Great Recession, and thus help to ensure their people against future economic turmoil. .

Opening Markets

We cannot forget that in the 1930s the world wide depression resulted from the toxic combination of a severe global economic imbalance and a near universal increase in trade barriers.

Keeping our bilateral markets open, while working to further open global markets, is a challenge which if addressed seriously would enhance the growth of our domestic economies while contributing to the expansion and stability of the global economy.

As headlines in our respective newspapers document, bilateral trade disputes have multiplied over the past 6 months. The United States has taken action to restrict the import of Chinese tires, steel pipe, magazine quality paper and various salts, and China has moved to restrict U.S. movies and books, poultry, auto parts, nylon and industrial acids and threatened to commence an investigation of U.S. made passenger cars.

These actions are not helpful. At each of the three G-20 meetings, the assembled leaders pledged not to erect barriers to imports, not to violate WTO rules, and not to impose export restrictions.



Yet the report published this past September by Global Trade Alert documents that G-20 members have put in place over 120 blatantly discriminatory measures and that nearly that many were in the pipeline. The United States and China are among the offenders.

While this sort of protectionism will not be stopped with pledges, it could be stopped if our two governments took the lead at the upcoming G-20 meeting to press for a real commitment to carry out the leaders' promises to keep their markets open and themselves set an example.

In addition the United States and China could work together to push the Doha Round to a successful conclusion and in so doing create new and exciting opportunities for Chinese and American entrepreneurs, while giving the global economy a real boost.

According to studies conducted at the Peterson Institute for International Economics, tariff cuts for agricultural and industrial goods, reductions in farm subsidies and market opening proposals for services now under discussion could boost world output between \$300 and \$700 billion a year. We need that growth now.

Open markets make a difference. It is thanks to open global markets that China has averaged double digit growth over the past three decades and created the jobs necessary to lift hundreds of million of people out of poverty. America's GDP would be more than twenty percent less today had it not led in opening global markets in the years following World War II.

Throughout history, no country has done well by sealing itself off from the world. Today globalization describes supply chains that encircle the globe and communications that in a nanosecond spread new ideas that feed innovation.

Yet there is a growing pressure in both of our countries toward economic nationalism. When unemployment is high, public pressure escalates to raise protective barriers against incoming goods, services, and investment.

We need to resist that pressure, for we know that it will decrease economic opportunity and increase hostilities. A successful resistance will require all of us to make a concerted effort to explain to our fellow citizens how opening markets stimulates economic growth, creates opportunity, and enhances global stability.

Too few people appreciate the extent to which legal and regulatory barriers limit development and creative endeavor. They need to hear from leaders in government, universities, think tanks, and businesses---groups represented here tonight--- how keeping domestic and global markets open is critical to their future prosperity.

Conclusion

For all of the issues that the United States and China face today---whether foreign policy, military, or economic---it is overwhelmingly in our national interests to maintain a close, candid,



constructive and collaborative relationship. As President Obama has said: “The relationship between the United States and China will shape the 21st century.” Through engagement we are more likely to find solutions to our differences and turn our challenges into opportunities.

We know that high level engagement works. Between 2006 and 2008 Cabinet Officials from both governments met for two days twice a year in what was called the Strategic Economic Dialogue. The goal was to discuss complex, long standing economic challenges and to craft solutions satisfactory to both governments.

Since both of our governments are quite compartmentalized and have different organizational structures, these meetings brought together the relevant high level officials on both sides to talk about critical issues. These face to face meetings enable both sides to understand the concerns of their counterparts and led to a number of positive outcomes. Importantly, such meetings help to avoid having to initiate talks among strangers in the heat of a crisis.

In 2009 the Obama Administration broadened the economic dialogue to cover strategic as well as economic issues. Last July’s two day meeting showed the newly formed Strategic and Economic Dialogue to be an effective forum for raising and discussing issues of mutual concern.

The next meeting is in late May or early June. My personal view is that the Strategic and Economic Dialogue should be held more frequently than every ten or eleven months, particularly now since the agenda is broader, the challenges are greater, and there are more participants. There is no substitute for face to face meetings to increase understanding. Relationships matter.

Both Doak Barnett and Mike Oksenberg believed in engagement. As they said, it requires patience and understanding. Our two great nations working together could shape history in a very positive way by making some tough decisions today that would ensure international peace and prosperity and a better life for our people tomorrow.

We will continue to have our differences. But let us recall the Chinese proverb: “Unless there is opposing wind, the kite cannot rise!”

Thank you.