National Committee on
United States - China Relations

中国经济研究中心

CONSENSUS VIEWS OF THE U.S.-CHINA TRACK II ECONOMIC DIALOGUE

January 6, 2015 New York

- Economic growth in China has been slowing for some time and may slow further to around 7% over the medium term. In 2015, both fiscal and monetary policies are likely to be somewhat more stimulative than in 2014. These efforts to create a stable macroeconomic environment are a key element to assure success of the government's economic reforms, which are necessary to sustain economic growth over the long run.

- Importantly, China has made progress over recent years in exposing an increasing share of its economy to market forces. For example, gradual interest rate liberalization is slowly bringing the cost of capital more in line with economic activity, although more work is needed to enhance the monetary transmission mechanism. Wages have been expanding rapidly, in part due to growing labor shortages. An important and desirable result of these changes is that consumption has become the largest contributor to economic growth, reflecting a major rebalancing of the Chinese economy that is likely to continue in the years ahead.

- At the same time, there remains great scope for additional reforms to improve the quality of growth and consumer welfare. Some of these opportunities relate to trade and cross-border investment and we describe these below in greater detail.

- In the United States, the recent surge in economic growth overstates the gradual improvement in the short-term outlook. Over the next year, consensus projections for U.S. economic growth are in the neighborhood of 3%, including the benefits from lower oil prices. From a long-term perspective, the expansion of supply capacity has slowed markedly compared to the pre-crisis trend, so that economic slack is significantly less than the weak recovery might suggest. Against this background, U.S. monetary policy probably will begin to normalize this year, but the normalization process is likely to take several years, which might also be affected by economic conditions in Europe and Japan.

- Both governments should focus on improving the prospects for long-term economic growth. It is not difficult to think of areas where progress can be made (especially cross-border trade and investment). In both countries, making progress will require strong political leadership to overcome the resistance of entrenched interests. In the United States, that challenge is complicated by the realities of a divided government.

- The participants agreed that the leading opportunity to advance the growth agenda and promote cooperation between the two countries is to reach early agreement on a serious Bilateral Investment Treaty (BIT) and naturally expand that into a negotiation on a U.S.-China Free Trade Agreement (FTA). As we stated in our previous consensus, each government should establish a high-level working group to conduct a feasibility study for an FTA between the United States and China to take place in the context of the Strategic and Economic Dialogue. While negotiating an FTA may take years, the process of negotiation itself promotes trust.

- Negotiations on a BIT have been going on for some time, but reaching agreement and then achieving enactment of the Treaty during the current U.S. Administration's remaining term will require greater urgency and commitment on both sides. A strong and effective BIT would establish a basis for further bilateral agreements such as a U.S.-China FTA and also will encourage progress in trade and investment agreements with other countries. U.S. firms have much to gain from an effective BIT and/or FTA, but such agreements should also enhance clarity of rules and transparency that reduce the uncertainties facing Chinese firms considering an investment in the United States. U.S. participants highlighted the need to obtain broad business support to make Treaty enactment politically feasible. The greater the range of activities that a BIT and/or FTA opens up, the greater the chance of obtaining such support.

- Another key set of opportunities arises from the enormous technological changes that have led to a collapse in the price of oil and other energy products. Both China and the United States should welcome the prospect of a sustained period of relatively low oil and gas prices that will contribute to economic growth over the short- and medium-term. Both governments will gain significantly from continuing to promote cooperative innovation and expansion in the use of alternative (renewable) energy sources (including solar and wind) and sustained conservation efforts that are necessary to meet global climate objectives.

- The source of technological change in oil and gas production also is important for both countries. The fracking revolution in the United States reflects the positive impact of competition and the efforts of small independent producers who developed more effective, low-cost production methods. Promoting such competition in China – for example, by allowing foreign direct investment as well as encouraging domestic private investment in energy production – would help accelerate technological advances there. Both countries would benefit from a more efficient energy industry in China.