National Committee on
United States - China Relations

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

June 19-21, 2013 BEIJING, CHINA

1. Economic Outlooks in China and the United States

The United States:

It was agreed the US is showing signs of somewhat stronger growth, though with substantial downside risks. Private sector activity is accelerating, offsetting the drag from government. Fiscal deficits have been reduced and state and local finances are adjusting rapidly. Housing markets are recovering and household balanced sheets have made substantial progress in deleveraging. The growth of energy output continues to benefit consumers and industrial producers. On the negative side, overall non-financial debt in the economy remains high and the savings rate is again falling. The reliance on nonconventional monetary policies, which has boosted asset prices, poses risks to the economy when that policy is eventually reversed.

It was agreed the Federal Reserve – as well as other central banks with similar policies – need to carefully manage this exit. The risks of an economic reversal are real if the exit process introduces volatility and dislocations to capital markets. Emerging markets are especially susceptible to outflows that could be disruptive, especially at a time when growth was already slowing. We urge central banks to intensify discussions so policymakers understand each other's reaction function.

It was agreed that it is critical for the United States to pursue microeconomic structural reform. Three areas where distorted incentives and badly allocated resources will sap the strength of the US recovery in the period ahead if reforms are not implemented are the tax system, which damages all areas of the economy; elementary and secondary education which will provide the basic skills of its labor force in the future; and healthcare which is draining more and more resources from both the public sector and the private sector without producing world class outcomes.

China:

China's current slowdown is more cyclical than structural. The whole world has entered an era of slow growth; China actually has done better than other countries. The Chinese economy has shown some signs of rebalancing. The share of consumption has been stabilized and trade is moving toward balance.

Short-term risks exist, though, while China's long-term fundamentals imply high growth rates in the long run. Leverage has increased in the country; M2 has reached 200% of GDP. However, inter-bank lending rates are increasing and interest rates in the informal financial sector are still high. Government balance sheets have been worsened and leverage in the corporate sector has increased. Growth of productivity has slowed down. This could be a structural shift although cyclical factors cannot be excluded.

It was agreed that the government should pay attention to short-term risks while forming a reform strategy. To facilitate structural reforms, Chinese government should stabilize short-term economic growth. Some of the short-term risks are linked to structural problems in the Chinese economy. For example, the contrast between fast growth of M2 and the high inter-bank lending rates shows that there are serious rigidities in the financial system. Therefore, reform will facilitate stabilizing short-term growth.

2. China's Reform Initiatives

The group had extensive discussions of the emerging Chinese economic reform program. The program is already underway, but an important milestone will be reached in October, at the third Plenum of the 18th Party Congress. While important parts of the reform program are still under discussion, the general outlines of the program are emerging. It is clear that the program will include important new measures in financial reform, fiscal reform, price reform, and improved market access that reduces regulatory hurdles that discriminate against private business. Moreover, the reform program is directly addressing the question of the proper relationship between government and market, and government and society. The group unanimously agreed that these reforms were highly positive developments that represented a major departure from the status quo.

This reform initiative is to a significant extent a response to the economic challenges China faces as it transitions to middle income status. In the past, the Chinese leadership consensus was that new reforms might be risky; today, the conviction is widespread that a failure to reform would be far more dangerous. For the American side, China's decision to launch a new reform process is highly positive. The focus of reform will inevitably be primarily on domestic regulations; however, improved market access and further opening will be positive for American businesses and the American economy.

The success of this reform initiative is by no means guaranteed. Firstly, China faces major structural problems that may disrupt the reform process, making it far from smooth. The group agreed that reform should be the primary means of resolving macroeconomic and structural challenges, and applauded the Chinese government's decision not to resort to quick credit stimulus in the face of moderately declining growth rates. Going forward, the complexity of reform inevitably means that it will inevitably have macroeconomic impacts, and policy-makers must be vigilant if the need arises to apply counter-cyclical macroeconomic policies. In addition, reforms face a current credibility issue. Reform policy-makers must overcome widespread skepticism (in China and abroad, including in the US) that reforms can overcome the essential institutional obstacles. The group urges policy-makers to build the reform process by making credible, observable commitments and expanding economic rights in order to support a sustainable reform process. Finally, the group noted there are many unresolved issues in the reform process. For example, the group unanimously supported the effort to create a new and clarified assignment of revenues and expenditure responsibilities to local governments. However, note was taken of the fact that critical decisions about the ultimate responsibility for key social services still remained to be made.

3. The Trans-Pacific Partnership and Bilateral Relations

The group recommended that China join the TPP negotiations and that the U.S. strongly encourage its joinder. To facilitate its joinder the group recommends that both governments accelerate the negotiation of a bilateral investment treaty and support the creation of an Eminent Persons Group to help reach a mutual understanding on challenging issues such as subsides, government procurement, export controls, market economy status, liberalizing service sectors, and protection of intellectual property. Joining the TPP negotiations will speed up economic reform in China and contribute to building the “Great Power Relationship” the two Presidents endorsed at their California meeting.

Both sides agreed that cyber security was an increasingly important source of tension in the bilateral relationship and thus there is a strong need to develop a protocol in this domain. Both sides noted that the United States and China have agreed to form a special working group on this subject as a key component of the Strategic and Economic Dialogue and expressed the hope that this will be an effective means to make rapid progress on this issue.

There continues to be misunderstanding on both sides on the nature of the national security review that each side imposes on the other with respect to certain M & A transactions. Both sides agreed that a mechanism should be developed that would reduce these misunderstandings so that cross border investment is facilitated rather than becoming an increasing point of contention in the bilateral relationship.