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

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- Economic growth in China has been slowing for some time, reflecting both structural and cyclical factors. On the structural side, China is making a long-term transition from export-led to domestic-demand-led economic growth. Signs of this rebalancing include the rising share of consumption in total demand and of services in production. Importantly, consumption is now the largest contributor to growth while services have surpassed manufacturing and construction as the largest component of production. These developments reflect in part the government's substantial progress in implementing economic and financial reforms approved in the 12th Five-Year plan and the Third Plenum.

- Securing a stable macroeconomic environment is vital for the continued advance of structural reform in China. Accordingly, the government has amplified its response this year to the cyclical slowdown which deepened in recent quarters as construction, investment and exports (export growth) slowed. Both monetary and fiscal policy are now clearly aimed at stimulating demand in the short-run and further actions to manage the extent of slowdown are possible as the year progresses.

- Improving the *quality* of investment is key to sustaining economic growth. Because the stock of capital per worker is likely to remain much lower in China than in the United States, Japan and other advanced economies, and because China is committed to capital-intensive urbanization, there remains a wide range of investment projects with high economic or social returns. Investment that is consistent with market principles and driven by sustainable market mechanisms is more likely to realize those high returns and foster optimal growth.

- In the United States, economic growth again has fallen short of expectations in the first half of 2015, much as it did in the first half of recent years. While another second-half pickup is likely, the overall performance of the economy in this six-year-old recovery is significantly weaker than in previous expansions over the past 70 years, with investment and personal consumption the most prominent underperformers. As a result, most observers have scaled back their expectations for the sustainable pace of economic growth. Even so, medium-term growth prospects are stronger in the United States than in Europe and Japan, and it remains possible that the U.S. outlook will improve with the continued repair of private and public balance sheets.

- Despite modest growth, ongoing improvement in the U.S. labor market is setting the stage this year for the first tightening of U.S. monetary policy since 2006. At the same time, Federal Reserve officials have warned that it may take several years for interest rates to reach a "normal" level, and (consistent with diminished long-run growth prospects) that level may be lower than the historical average.

- Like China, the U.S. government should focus on improving the prospects for long-term economic growth. It is not difficult to think of areas where progress can be made (including liberalization of cross-border trade and investment, expansion of immigration, and the improvement of infrastructure and education). In both countries, making progress requires strong political leadership to overcome the resistance of entrenched interests.

- Participants discussed a range of international initiatives that began in 2013 under China's current leadership. These include the Asian Infrastructure Investment Bank (AIIB), the New Development Bank (NDB; formerly called the "BRICS" bank), and the "One Belt, One Road" (OBOR) strategy. Together, these undertakings represent an important shift by China toward an outward-facing leadership role consistent with its increased scale in the global economy and with the associated responsibility as a supplier of global public goods. These new initiatives also increase the importance of consultation between China and the United States to ensure cooperation in promoting development in the emerging world.

- In particular, participants agreed that the recent success of the AIIB initiative in attracting a broad group of founding countries presents an important opportunity for the United States and China to engage together constructively to promote economic growth in Asia. Treasury Secretary Lew recently stated that "the United States stands ready to welcome new additions to the international development architecture, including the AIIB, provided that these institutions complement existing international financial institutions and that they share the international community's strong commitment to genuine multilateral decision-making and ever-improving lending standards and safeguards." Accordingly, in light of early indications of high standard AIIB governance and associated commitments to collaborate with existing international financial institutions (IFIs), U.S. participants encourage the United States to explore membership in the AIIB at an early date.

- At the same time, U.S. participants encourage Congress to pass legislation approving the 2010 quota reforms at the IMF. These reforms will anchor the legitimacy of the Fund (and other existing IFIs) by giving China and other emerging economies a policy voice commensurate with their increased role in the global economy.

- With the rapidly approaching September state visit to Washington of China's leader, Xi Jinping, participants also agreed that there is a window of opportunity to advance the economic growth agenda and promote cooperation between the two countries by reaching an early agreement on a Bilateral Investment Treaty (BIT). Negotiations on a BIT have been going on for some time, but reaching an agreement on and then enacting a Treaty during the current U.S. Administration's remaining term will require much greater urgency and commitment on both sides. U.S. firms have much to gain from an effective BIT, as do Chinese firms. The agreement should enhance clarity of rules and transparency to reduce the uncertainties facing Chinese firms considering an investment in the United States and U.S. firms considering investment in China. Both sides should shrink their negative lists to broaden opportunities in areas like financial services and high technology products to expand the mutual benefits. 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 opens up, the greater the chance of obtaining such support becomes.

- Participants also discussed the recent and prospective acceleration of financial reform in China, including both domestic interest rate liberalization and the opening of the capital account for cross-border transactions. Participants welcomed the advance of financial liberalization, again reflecting the implementation of initiatives endorsed at the Third Plenum. There was strong agreement on the growth- and welfare-enhancing benefits of financial liberalization, including the ability to mobilize and efficiently allocate savings, while improving the sharing of risks.

- There was also agreement on the need to enhance the resilience of the financial system in the face of greater financial volatility associated with liberalization. Mechanisms to safeguard the financial system include the development of advance indicators of systemic risk, the implementation of credible stress tests that promote effective risk management, the preparation of strategies to address possible financial disruptions, and the control of expectations regarding financial rewards and risks. In the current market environment, participants expressed concern about the risks associated with margin-driven increases in equity valuations in China, but also noted the opportunity over the long-run to increase the role of equity finance (and diminish reliance on debt) as China's equity markets broaden to include the issues of smaller- and medium-sized firms.

- In recent years, China has successfully encouraged much wider use of the renminbi (RMB) for use in *trade settlement*. As a result, the RMB is now the fifth most widely used currency in the global payment system. The implementation of Government plans to continue opening the capital account will encourage significantly wider use of the RMB over time, for example, in cross-border *portfolio transactions*. The participants welcome this broadening liberalization and view it as setting the stage for inclusion of the RMB in the Special Drawing Rights (SDR) currency basket of the IMF, which relies on "widely used" and "widely traded" standards for inclusion of a currency in this basket.

- More important from a long-run growth perspective is the increasing access of foreign investors to China's equity market. Rising foreign ownership is enhancing the chances for including Chinese equities in the most widely used benchmark index for global equities. Again, participants welcome the efforts of Chinese authorities to give savers around the world the opportunity to own and trade the shares of firms in China.

- Finally, and most broadly, participants agreed on the importance of advancing a cooperative agenda on economic and financial matters as a means of anchoring the bilateral relationship in a rapidly changing and uncertain world. Participants encourage both countries to focus on their common interests in promoting global economic growth and managing challenges to that growth agenda.