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The tenth Aspen Institute Congressional Conference on U.S.-China Relations was convened March 24-30, 2008 in Lanai, Hawaii. Members of Congress, from both chambers and both political parties attended, engaging in four animated and productive formal conference sessions. In addition, there were other collateral educational activities, one being a briefing on the recently concluded presidential election on Taiwan delivered by a former member of the Legislative Yuan in Taipei (Ms. Bi-khim Hsiao). The formal conference sessions dealt with Economic Issues in U.S.-China Relations (Presenter, Dr. Nicholas R. Lardy); Prospects for Political Liberalization and China’s Political Leadership (Dr. Susan Shirk); China’s Military Modernization on the Land and Sea, in the Air, and in Space (Admiral and Professor Dennis Blair); and The Nexus of Energy, Global Warming, and Environmental Concerns (Dr. Lin Jiang). In addition to the above U.S. scholars who wrote briefing papers (provided in this volume) and led each of the four conference sessions, were additional scholars from the United States, the People’s Republic of China (PRC), and Taiwan who contributed greatly to the formal conference sessions and bilateral consultations that occurred between formal sessions.

The context of developments in China itself, in U.S.-China relations, in Taiwan, and in the broader global system provided the backdrop for conference discussions. In China itself, on March 10th, two weeks before the conference, demonstrating Buddhist monks and others in the Tibet Autonomous Region (TAR) began to express dissatisfaction with PRC human rights-related policies (religious clampdown, resettlement policies, more basic issues of autonomy, and cultural and economic frictions with Han Chinese). These demonstrations produced arrests, which in turn cascaded into violence against Han Chinese citizens in Tibet on March 14th, which (after initial hesitation), in turn, developed into a crackdown principally with Chinese paramilitary forces. At the same time, demonstrations spread from the TAR to parts of neighboring provinces with significant Tibetan populations. By the end of March and early April, there was some evidence that the Uighur minority in Xinjiang was becoming somewhat restive. This unfolding sequence of events and the global media coverage of them, in turn, held out the prospect of affecting the August 2008 Olympic Games.

Also in the first half of March, China’s National People’s Congress convened in Beijing, appointing personnel to key state positions and creating “super-ministries” and other organizations to deal with issues of mounting concern both to China’s people and the global system—most notably elevating the status of the

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State Environmental Protection Administration to the ministerial level and trying (only partially successfully) to get a handle on China’s energy policy. The National People’s Congress also brought more clarity to the issue of which Chinese political personalities are likely to play key roles in the post-Hu Jintao era that is anticipated to start in the fall of 2012 at the Eighteenth Party Congress.

In Taiwan, on March 22nd the election for president of the Republic of China (ROC) was held. The Kuomintang (Nationalist) Party candidate Ma Ying-jeou won by a decisive margin, and two referenda expressing desires to be in the United Nations failed to pass. All in all, these were results that had the effect of immediately calming tensions in the Taiwan Strait, at least temporarily, though there still were residual concerns on the mainland about how President Chen Shui-bian, who would remain in office until May 20th, would use his remaining time.

Turning to the U.S.-China and global contexts, China’s December 2007 crossing of the $1.5 trillion threshold in foreign exchange holdings, with perhaps in excess of $930 billion held in various dollar-denominated debt instruments, was a subject of concern, as was Beijing’s recent creation of the China Investment Corporation (CIC), a sovereign wealth fund. The purpose of CIC is to more productively invest China’s funds in tangible and other higher yielding assets.

Product safety is an issue that spans the bilateral and global categories. For more than a year the safety of toy and food exports from China have been a mounting public and government concern globally, but on the eve of the conference the possible lethality of some pharmaceutical products in which key components had come from China was stirring concern—deaths had been attributed to heparin components coming from the PRC. While actual responsibility was still being sorted out, these developments gave urgency to the more generalized problems of product quality and safety.

Another area of concern was China’s early 2007 shoot-down of an aging weather satellite (creating about 11 million pieces of space debris that required the Space Lab to move to a somewhat different orbit). From a security perspective, this demonstrated a Chinese capability to put U.S. space assets that are important to American (and other countries’) civilian and military communications and sensing systems at risk. The following year (January 2008) the United States destroyed one of its own satellites (that soon would have fallen from orbit) to protect persons on the ground from toxic materials onboard and from plummeting debris, but also simultaneously demonstrating (after already having done so in the mid-1980s) the reciprocal U.S. capacity to hold at risk the space assets of others.

These internal, bilateral, and global developments provided part of the complex contextual background for both the briefing papers and conference sessions summarized below.

Dr. Nicholas R. Lardy at the Peterson Institute for International Economics, started the first conference session on: “Economic Issues in U.S.-China Relations: Currency Reform, the Trade Deficit, Debt, Food and Product Safety.” Moving beyond his briefing paper Lardy emphasized that while Chinese economic successes were not to be ignored, there were three areas in which Beijing’s economic policies were “off track”: the under-pricing of currency, energy, and capital. In turn, this under-pricing was creating imbalances and distortions in both the domestic and global systems. China’s currency remains significantly undervalued, contributing to a rapidly growing global trade surplus. Though Beijing has revalued modestly vis-à-vis the U.S. dollar (15 percent), the trade-weighted exchange rate had risen only about 10 percent. Consequently, the Europeans and others are beginning to complain ever more loudly about the unfair advantages the exchange rate confers on the PRC. Beijing now recognizes the problems, perhaps its own fight against inflation will energize more rapid currency appreciation, but the bottom line to date is—Beijing still “has not done a lot.”
Likewise, energy now is substantially priced below the world price level, even though about four years ago it was near world prices. With price caps on the domestic sales price of fuel, refineries are losing money and imports are growing rapidly. While reflective of popular opposition to rising energy prices, this under-pricing undermines incentives for conservation, further strains global supplies, and is part of the reason for a disconcerting recent rise in China’s energy intensity—the amount of energy needed to produce each unit of GNP.

Finally, capital also is under-priced in China; with inflation near 9 percent per year and the lending interest rate about 7 percent, it pays to borrow. The result is capital (and energy) intensive growth, the creation of excess industrial capacity, and reduced ability to bring about price stability and avoid sectoral bubbles. Being off track along these three dimensions contributes to many problems the national administration says it wishes to resolve: excessively rapid growth, environmental degradation, inflation, and inequality.

There are several things that the Chinese administration could do to move things in the direction of its declaratory policy and relieve pressure in the U.S.-China relationship. Among those actions are: increase corporate profits taxes in China; raise interest rates, appreciate the Renminbi more quickly, and promote faster financial system reform (including providing more rapid access for global financial services firms to the Chinese market).

In response to Dr. Lardy’s initial remarks and his essay that follows this introduction, Members of Congress and other participants had the following reactions, questions, and concerns:

- Does anything we do [leadership visits, legislative bills] make any difference to Chinese behavior, like food and product safety? Jobs will trump anything. Do the Chinese know we will react?
- In Silicon Valley the Chinese are outsourcing in our direction. How do we understand interdependence?
- Tool and die makers in my district got hooked up with China and business is better than ever.
- The U.S. economy is “tanking” and there will be increasing efforts to find scapegoats. China will be high on the list. What are the tools to get the Chinese to do what you [Dr. Lardy] suggest?
- Sovereign wealth funds are a very troubling concept...in part because it is foreign governments, not individuals. The U.S. Government is not allowed to invest in corporate America. Sometimes strategic interests outweigh common interests.
- We need to reform our fiscal policies. Lower the deficit, higher personal savings; money is running up hill [that is, from poor China to rich America].
- China is more concerned with economic nationalism after adopting a liberal investment regime. There are deep interest group pressures in China.
- The populist approach to economic management is at all government levels in China, so governments are controlling prices—energy, agricultural goods, and such ridiculous incidents as Lanzhou Noodle prices.
- Drive time from Beijing to Hong Kong has gone from 55 hours to 24; and travel time between Beijing and Shanghai has gone from 35 hours to 14 hours. China can offload one container every 1.5 minutes. It now takes 400 hours for soybeans to go from Iowa to New Orleans. Look at
Brazil—it has a six-day sail advantage to China. China is racing ahead in infrastructure [compared to the United States].

- China is developing or completing 68 subways—the U.S., zero.

The second conference session featured University of California-San Diego Professor Susan Shirk who led off the session entitled, “Prospects for Political Liberalization in China and China’s Political Leadership.” She started with the observation that the pace and depth of political change in China had proven slower than she had anticipated years earlier. She wanted to reflect on the possible reasons for the lack of correspondence between expectations and today’s reality.

First among the reasons were the violent events of June 1989. “This was a very close call for the Chinese system.” Chinese leaders split and only because the People’s Liberation Army (PLA) followed Deng Xiaoping did the Chinese Communist Party (CCP) regime survive. Consequently, post-1989 leaders felt that their grip on power was fragile. The Berlin Wall and the Soviet Union fell. Chinese leaders may not worry about the next election, but they do worry about regime survival.

Because of this basic regime nervousness, post-1989 Chinese leaders have essentially adopted a three-part strategy for regime survival, beyond maintaining economic growth and prosperity: 1) Prevent mass protest; 2) Hide from the populace, or prevent any signs of leadership division because visible leadership fissures could either be exploited by disaffected citizen groups or leadership fragments within the elite itself could seek to mobilize parts of the populace to gain advantage in intra-leadership struggles; 3) Keep the military loyal, in part, with increased military spending.

However, while political change (citizen rights and popular participation) have “not improved much,” the Chinese have been trying to improve “governance”—governance meaning responsiveness to incipient popular complaints in the hope of heading off potentially disruptive political opposition. This concept of “responsiveness” is developed in Dr. Shirk’s briefing paper provided later in this report.

In terms of political leadership, the elite have been fairly successful at managing the oligarchy to keep it together. The current elite have identified the outlines of the next generation of leaders that is gaining experience in the wings of the present administration. This group in the wings looks like the outcome of a bargaining process among current senior leaders; the resulting arrangements do not entirely reflect the initial wishes of President Hu Jintao (as we currently understand those inclinations). If Hu had to accept a succession package that did not entirely conform to his initial desires, this speaks to a significant change in elite politics and raises the question of whether or not there could be challenges to these arrangements, challenges possibly originating in the elite itself or from society. Any popular or intra-elite fissures could be exposed and/or driven by an increasingly commercially driven mass media, the Internet, and/or unanticipated developments such as the current Tibet-related turmoil. “Dramatic political change could occur—dramatically, suddenly,” Shirk cautioned.

In response to Dr. Shirk’s initial remarks and her essay, Members of Congress and other participants had the following reactions, questions, and concerns:

- The Chinese Communist Party wants to prevent the emergence of another communist party, so it is actively shaping [views]. It wants to make the public more satisfied. The Party is sensitive to the well-educated. The Chinese government is getting smarter. They can’t guarantee [regime] longevity but there will be more stability for the long term.

- China has changed politically over the last thirty years. Had there been no change you couldn’t now be talking about rule of law, individual rights, human rights, and democracy, all discussions now occurring
in the PRC. So, at the level of ideas, the struggle is over. The threshold has been crossed.

• China now is emphasizing democratization of the decision-making system rather than elections.

• Sometimes Americans are too apologetic. We used to tear the Soviets apart—we don’t demand too much of China. We are giving the Chinese a pass we wouldn’t have given the USSR. We don’t have the same commitment to change in China as we had in the USSR.

• It is curious that after all this discussion there has been no mention of the Falungong, Tibet, Taiwan, or Hong Kong. Timidly off the table. This is puzzling. Any country with “People’s” in its name is oxymoronic—people don’t have much to do with it. China has crossed the Rubicon. Academics find the glacial pace of political change disappointing; politicians find it maddening. The world’s superpower—how hard should we push on Tibet?

• Too often we are too arrogant. We are involved in too many places. Now our economies are interdependent.

• Business people are not here. They’d say, “Do business.”

• Regarding Tibet: Was it orchestrated or spontaneous? Systematic, planned on the eve of the Olympics... Was the response too harsh or too late? Too late, probably...the Chinese Government’s initial approach was the united front of Han Chinese against “separatists.”

• What are our Chinese guests looking for in political reform? What is the end point? In your view, what are you moving toward?

• There always is a mismatch between the economic and political reports at the Party and National People’s Congress sessions. China doesn’t have a strong leader with vision.

• No one anticipated 1989, the Falungong, SARS in 2002-2003, or the 2008 snowfall. You don’t need revolutionaries. You just need unhappy people.

• Do we have a double standard? We have an alternating standard. What I see is a swing between fascination and fear.

• There is no reason the Chinese Communist Party cannot do what the Kuomintang did in Taiwan—maybe 20-50 years. If the CCP wants to survive it has to represent the people and do what is demanded by its economic opening.

• Many Americans feel seriously vulnerable. We become less forthright. We either engage in hyperbole—fear—resolutions. Or, we pull our punches talking to Chinese. This is all justifiable given the unknowable future.

The third conference session, “China’s Military Modernization on Land and Sea, and in Air and Space,” was led by former commander of the U.S. Pacific Command and now professor at Dickinson College, Admiral Dennis Blair. He commenced the discussion by noting that any military thinking has to be relational among military forces—in the case of the Pacific, among other things this means thinking of U.S.-China-Taiwan forces in relationship to one another.

In the Pacific theatre, U.S. air and naval forces had been placed under relatively little strain by conflict in the Middle East and Central Asia and this, combined with some repositioned capabilities in the region and modernized defense systems and platforms, cumulatively means that “U.S. modernization in the Pacific is impressive.”

With respect to Taiwan’s capabilities, since about 1996 PRC defense efforts rose at precisely the time Taiwan began to devote relatively less effort to military modernization. One reason for this relative decline in Taiwan’s defense modernization effort was political party change on
Taiwan; the then newly-dominant political party (the Democratic Progressive Party—DPP—and its newly-elected president in 2000, Chen Shui-bian) did not trust the Taiwan military because of its historically close links to the former ruling party, the Kuomintang, or the Nationalist Party. Moreover, the DPP was more oriented toward meeting pressing domestic, non-military needs than the former ruling party had been. However, with the recent (March 2008) presidential election in which the Kuomintang won (albeit a rather different Kuomintang than had been the ruling party up to 2000), there now is a commitment to increase defense spending as a percentage of GDP. Taiwan “can do what it needs for a robust self-defense capability.”

Turning to broader issues of the U.S.-China military relationship, if you were a “man from Mars” you would likely perceive that there are many areas in which Chinese and U.S. interests run parallel or overlap. Among those areas are: North Korea (the DPRK), Darfur, and Myanmar. There is at least the possibility of working in parallel in these areas. But whatever degree of cooperation there has been diplomatically has not thus far been translated into military-to-military cooperation. We [the U.S. military] should be talking about the DPRK with China. We are not talking about who ought to be doing what in the event of various contingencies in North Korea.

In response to Admiral Blair’s initial remarks and essay, Members of Congress and other participants had the following reactions, questions, and concerns:

- The PLA is increasing its capabilities and modernizing its obsolete forces, particularly given the Gulf War of 1991. So, after a decade and a half of military modernization some debate has arisen. The PLA has a limited distance attack capability. The Air Force is old; the Navy has aspirations, but not funding. We have a number of missions…Chinese people will watch what we do and China respects U.S. legitimate interests in the world.

- The U.S. encourages Taiwan to build up. The U.S. tries to dissuade China from challenging the U.S. regional role. The Chinese military argues to the National People’s Congress.

- The U.S. should reassure the PRC that it has no intention for independence of Taiwan. Change your policy from peaceful resolution of the Taiwan issue to peaceful, democratic reunification of the mainland and Taiwan.

- China is building relations with Southeast Asia—Laos, Cambodia, Burma, highways to the sea. What are the strategic objectives of all this? But, we should try to de-conflict issues here.

- Chinese decision-making has not matured.

- With respect to the string of pearls idea [island chain outposts China can use to extend its reach in the Pacific, South China Sea, and Indian Ocean areas], there is a lot less there than meets the eye. China has nothing like our forces or facilities throughout Asia. The bases are not there, nor are their operating patterns there.

- I am concerned about China, but not terrified. They don’t have force projection. They may not have the capability to invade Taiwan…We are under assault from cyber war and a lot of it from the PRC. Asymmetric. The way to attack us is our satellites and information systems…

- Cyber attacks. In peacetime these attacks on the military domain are causing us to find our vulnerabilities. The U.S. has the tools to do this. So what is going on makes us tougher when it counts. It would be nice to have a truce, but we can handle it.

- Regarding Taiwan, is it possible for the Prodigal Son to return to the family without returning to the house, but to live in the compound?
China could declassify what most other countries make open. There is grudging movement in these areas. They need to speed it up.

It is easy to see weapons but hard to discern intentions and connect them to national strategy. The obstacle in the future is not just Taiwan, but we also have different strategies in the world; different political systems. Where is it going? Sun Tzu said the best way to achieve objectives is not to fight.

I don’t think the Chinese civilian leaders feel they are really the commander in chief of forces...The PLA uses Taiwan to increase its budget. I don’t think the PLA is in a healthy place. A national army, not a party army, would be better.

Even peaceful resolution of the Taiwan issue would not diminish the need for U.S. forces in Asia—Japan would be more nervous with reunification. Has the anti-terror cooperation between the U.S. and China really been significant and sustainable?

Cooperation in counter-terrorism is mainly intelligence and police cooperation, not military cooperation. In the Shanghai Cooperation Organization the U.S. asked for observer status and was denied it.

Saying that the Air Force and the Navy haven’t been stressed by the Afghan and Iraq wars is only partly true. In terms of budget there is big stress in rebuilding the armed forces. The Air Force and the Navy are concerned about the out years.

Last weekend [with the Taiwan presidential election and referenda on the ballot] the PLA was on alert, willing to take action. The U.S. had two carriers on alert in the area. If the referendum/referenda had passed, there might have been action. They were poised. The voters of Taiwan bailed the PLA out.

The last thing we need is another war, though we have been willing to act. In my state it is easy to convince people that China is an economic and security threat. Elected officials have a responsibility to be more temperate.

Let’s try to work out an understanding on Taiwan at this moment.

The fourth and final session was “The Nexus of Energy, Global Warming, and Environmental Concerns: Opportunities for U.S.-China Cooperation.” Dr. Lin Jiang, vice president of the Energy Foundation, made initial remarks and led the follow-on discussion.

The Chinese economy has expanded 15-fold in the last three decades, but the environment barely registered in Chinese consciousness in the 1980s. “Development now, environment later” was the apparent thinking. Now, however, it is clear that the environmental costs literally are breathtaking—500,000 die prematurely each year because of air pollution. Environmental concerns have become a major cause of mass protests. Indicative of the problems is Lake Tai’s algae bloom in the summer of 2007 that cut off water for the city of Wuxi for a week. The Chinese national system is totally unprepared to deal with a set of nationwide environmental problems of this scale, though leaders now have grasped the magnitude of the problem confronting them. The issue is how to effectively overhaul China’s environmental management system? The State Environmental Protection Agency was elevated to the ministry level at the just-concluded session of the National People’s Congress.

Turning to energy, Chinese use one-sixth the energy per capita that Americans consume. Energy growth was half the rate of GDP growth from about 1985 up until 2001. Since that time, however, energy growth has been much faster than GDP growth. Part of the reason for this undesirable turnaround is that China has become the factory of the world, with developed economies offloading to China more
energy and pollution-intensive industries, not to mention that Chinese are becoming more middle class, desiring and buying more appliances and automobiles.

In terms of achieving local compliance with environmental directives issued by Beijing, economic growth is what advances the careers of local cadres and generates the local jobs that contribute to social stability. And, when all is said and done, "The mountains are high and the emperor is far away." Beijing’s capacity to assure implementation of environmental regulations is "really quite limited." Before the recent reform announced in March at the National People’s Congress, the State Environmental Protection Agency had only 250 staff.

In response to Dr. Lin’s initial remarks and essay, Members of Congress and other participants had the following reactions, questions, and concerns:

- My guess is that the government is not serious about implementation, not that it can’t.
- There have been major disasters near urban areas. They will not sit idly by. There was a plant protest in Xiamen. Text messaging is being used to organize protests. Taxes, employment, stability, and profitability all are considerations that affect local implementation.
- They are not serious. It is not like the one-child policy. They had hard targets. Beijing needs to mobilize NGOs to monitor all this.
- There should be an international consortium to begin to develop carbon sequestration technologies.
- China has ten million big freight trucks and they are diesel and they have low standards and price controls keep down the price of diesel.
- How big a problem is the U.S. lack of commitment on these issues [like global warming]?  I really question Beijing’s will on this. They subsidize fuel prices below international prices. They have increasing energy intensity. They are demanding that the West take disproportionate responsibility for solving these problems. The reason for lack of will is that the leaders are insecure about riots over slow growth.
- With respect to major coastal cities, Chinese leaders at the local and national levels are worried about a rise in the water level. And, China sees this as a moment when global environmental standards will be set and it needs to participate.
- We may have to put environmental tariffs on Chinese exports—pay there or pay here.
- Chinese have to balance GDP growth with environment and rising expectations. Price controls make people happy. When the China National Offshore Oil Corporation raises prices, people say the company is ripping off the people.
- Also, corruption is a problem at the local level. Some local officials have vested interests; it is difficult to make them comply.
- There are lots of words on U.S.-China energy and environmental cooperation but little action. We need joint development of new technology and technology transfer.
- China’s data collection methods have deteriorated seriously and environmental monitoring is a real problem.
- When you look at problems you become pessimistic. But, if you take a historical approach, there has been lots of progress. Don’t underestimate the Communist Party’s capacity.
- Soon we will be serious. China’s CO2 will exceed the U.S. and EU and others will pressure China.
Core Economic Issues in U.S.-China Relations: Currency, the Trade Deficit, Investment and Finance, Food and Product Safety

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Global Economic Imbalances and the Chinese Currency

In contrast to the first 25 years of reform when its net external trade position was very modest, in the past few years China has become a major contributor to global economic imbalances. This is reflected in China’s soaring current account surplus, which reached $250 billion in 2006 making it the world’s biggest current account surplus country. The surplus expanded further in 2007 on the back of a 50 percent increase in the trade surplus and is anticipated to have reached close to $400 billion (official data on the current account are expected to be released in May). That will place China’s global current account surplus in 2007 at almost 12 percent of Gross Domestic Product (GDP), an unprecedented level for one of the world’s top trading economies. For comparison, recall that Japan’s global current account surplus in the mid-1980s, at the height of trade frictions with the United States, peaked at 4.3 percent of its GDP.

The emergence of trade and current account surpluses on the scale that have occurred in China in the past three years appears to reflect perhaps the most important economic policy error of the reform era, not the adoption of mercantilist trade policies. Indeed, unprecedented trade surpluses emerged after China joined the World Trade Organization (WTO) in late 2001 and was opening its market to foreign trade and investment by dismantling a large number of trade barriers and liberalizing further its foreign investment regime. What was the nature of this policy error?

China’s policy error was its failure to recognize that its fixed exchange rate vis-à-vis the U.S. dollar would, as the value of the dollar fell from its peak in February 2002, inevitably make Chinese goods more competitive globally and thus, with a time lag, lead to a rising global trade surplus. They also appear not to have appreciated sufficiently the rapid pace of productivity growth in China’s export sector. This allowed export producing firms to lower their prices in domestic currency while maintaining their profitability, which compounded the tendency for Chinese goods to become ever more competitive globally.

For part of this decade the rise in China’s global trade surplus coincided with a rise in the U.S. global trade deficit. But developments in the past two years underscore the fact that the correlation of these trends does not imply unique causation. In response to the depreciation of the U.S. dollar, which has now fallen about 15 percent on a trade weighted basis since its February 2002 peak, and to the improvement in the U.S. national savings-investment imbalance (due largely to a declining fiscal deficit) the pace of expansion of the U.S. trade and current account deficits began to moderate as early as 2005. Since the
third quarter of 2006 these deficits have been shrinking both in absolute terms and as a share of GDP while, as already noted, China’s global trade and current account surpluses have continued to rocket ahead.

This delinking between the external positions of China and the United States is likely to continue as households in the United States begin to increase their savings from disposable income in response to declining housing prices. And if economic growth in the United States should slow further in 2008, or the U.S. even tip into recession, this disparity would be further accentuated since demand for imports in the United States would fall sharply, accentuating the pace of decline in the large U.S. global deficit that is already underway.

Nonetheless, China could contribute to a more rapid reduction in the U.S. global external deficit by rebalancing its own economy, reducing its dependence on a growing external surplus and an excessively high level of domestic investment but maintaining rapid economic growth through increased government outlays on social programs and by adopting policies to encourage more robust private consumption expenditures. The Central Committee of China’s Communist Party called for rebalancing as early as 2004, focusing at that time primarily on reducing China’s excessive dependence on investment to generate high economic growth. Premier Wen Jiabao in the spring of 2007 expanded the rebalancing agenda by calling for a reduction in what he called China’s “excessive trade surplus.” Achieving this objective will require not only a further appreciation of the Chinese currency (a process that has been underway for three years) but also adjustments in both its fiscal and financial policies.

A faster pace of currency appreciation, which appears to have emerged in December 2007, if sustained would tend to reduce the growth of Chinese exports and contribute simultaneously to faster import growth. Several other Asian countries with undervalued exchange rates would likely follow China’s faster appreciation by allowing their own currencies to appreciate more rapidly. That, in turn, would lead further to the decline in the trade-weighted value of the dollar, contributing to a further reduction in the U.S. global current account deficit.

On the fiscal side the Chinese government needs to significantly increase the dividend tax on state-owned corporations introduced last year. Profits of these firms have soared in recent years and become the major source of investment finance. A sharply higher dividend tax would not only cut business savings and thus reduce corporate investment as well, but it would also provide the government with additional fiscal resources to increase government outlays for health, education, and pensions. That, in turn, would encourage households to save less and spend more, a necessity if China is to transition to more consumption driven growth—the key goal of its rebalancing strategy.

Finally, the central authorities need to abandon their policy of heavy financial repression that has caused household interest income as a share of GDP to fall sharply, even as the stock of household savings in banks has risen considerably. China is not likely to be able to transition to a more consumption driven growth path if household income as a share of GDP continues to fall, largely as a result of declining returns to savings.

To date Chinese policy initiatives along these lines have been modest. Through December 2007 the trade weighted real value of the RMB (Chinese currency) had appreciated only 3 percent from June 2005, just prior to the time the authorities began to allow the exchange rate to move above its long time fixed rate of RMB 2.8 per US dollar. The government, however, has reinforced currency appreciation with several other policy moves that have the same effect as currency appreciation, i.e., increasing the cost of Chinese goods in global markets and reducing the price of imported goods in China. The rate at which the domestic value added tax is rebated to producers on goods that are exported has been reduced for a broad range of goods
and for some goods eliminated entirely; import duties on a few goods have been reduced below the levels mandated by China’s WTO commitments; and duties have been newly imposed on some export goods.

Government outlays for health and education programs have increased sharply in absolute terms since 2004. This has allowed, for example, the elimination of primary school fees throughout China and provided a substantially larger share of the population with at least some health insurance coverage. If sustained these increases are likely to reduce the precautionary demand for savings on the part of China’s households and thus lead to greater private consumption outlays relative to disposable income.

On the financial front less progress has been made since multiple interest rate increases in the past two years have not kept up with rising inflation, leaving savers earning ever lower real returns.

On balance the prospect is that the rate of expansion of China’s trade surplus will slow further in 2008. By 2009 the external surplus is likely to peak in absolute terms at a very elevated level or even begin to shrink slightly. Thus, in the near term, further reduction in the U.S. global external deficit will have to depend largely on domestic economic adjustments in the United States.

**China’s Foreign Exchange Reserves**

As a consequence of the heavy intervention by the Chinese authorities to slow the pace of RMB appreciation in recent years China has accumulated far and away the world’s largest stock of official foreign exchange reserves. By the end of 2007 reserves stood at $1.53 trillion. While China, like most countries, does not disclose the currency composition of its reserves, it is widely believed that about two-thirds, or about $1 trillion at year-end 2007, were held in the form of U.S. dollar claims. The balance was held in assets denominated in other currencies, such as the Euro and the Japanese Yen. China’s holdings of U.S. Treasuries are estimated at $425 billion. Its holdings of so-called U.S. agency issues, mostly mortgage backed securities that are guaranteed by Fannie Mae and other U.S. federal agencies, amount to approximately $400 billion. The balance of China’s dollar-denominated reserves is held mostly in corporate debt.

There are several apprehensions concerning China’s large and growing holdings of dollar denominated financial assets, especially U.S. government bonds. Perhaps the most important is the fear that China’s investment position somehow gives it leverage over the United States, because it can threaten to reduce its dollar holdings in response to U.S. policies it finds objectionable. In theory this could lead to an increase in interest rates in the United States, thus slowing U.S. economic activity.

It is probably more accurate to say that China’s large holdings of dollar assets makes the two countries mutually interdependent in financial terms rather than providing unilateral leverage to China. As long as domestic savings in the United States are insufficient to finance our investment we will have to borrow the difference from the rest of the world. As long as China continues to have domestic savings that are well in excess of its domestic investment it will have to lend these surplus funds internationally. If China sought to put a substantially smaller portion of its growing foreign exchange reserves into U.S. dollar denominated assets or to sell a substantial portion of its existing dollar holdings and replace them with assets denominated in other currencies, interest rates in the United States likely would adjust upward slightly, at least in the short run. Depending on the posture of U.S. monetary policy at the time, this could impose a real economic cost on the United States. On the other hand, because this adjustment by the Chinese would drive the value of the dollar down, it would cause China to sustain large capital losses on its remaining holdings of dollar denominated assets. With Chinese reserves at year-end 2007 equal to the equivalent of half its GDP, losses associated
with a decline in the value of the dollar could be substantial. Thus mutual interdependence between the United States and China reduces the risk that China would attempt to use its large foreign exchange reserves as a lever to unilaterally advance its own interests at the expense of the United States.

Finally, as countries with large foreign exchange reserves seek to increase their returns many have transferred more and more of these funds to sovereign wealth funds that seek higher returns than are available from the predominantly fixed income investments made by central banks. China joined this process last year when it created the Chinese Investment Corporation (CIC) to invest a portion of China’s reserves. In recent months, as these funds (including CIC) have invested almost $40 billion in large U.S. banks, investment companies, and other financial institutions, two broad questions have been raised.

First, the motives of sovereign wealth funds are not necessarily simply balancing economic returns and risks. They may seek to promote the economic interests of their own country or pursue geopolitical goals that would not otherwise be an element in the business decisions of the financial institutions these funds, in effect, are rescuing. The absence of much transparency of most sovereign wealth funds makes it difficult to judge their motives or even to identify their principal investments.

The second issue is whether the existing U.S. regulatory framework should be adjusted to subject the investments to closer scrutiny and perhaps restrictions. The U.S. Treasury appears to have responded to these concerns not by proposing adjustments to the CFIUS (Committee on Foreign Investment in the United States) process, but by asking the International Monetary Fund to encourage sovereign wealth funds to increase their transparency and to agree voluntarily to a code of conduct that would reassure the United States and other countries in which these funds are investing. The terms of this code and its enforcement provisions will be key U.S. policy interests.

Food and Product Safety

In 2007 concern in the United States about the safety of food and other products imported from China soared as the media reported on a growing list of problem imports from China, including pet food, fish, toothpaste, and toys. This led President Bush in July to establish The Interagency Working Group for Import Safety. It was charged with analyzing the strengths and weaknesses of existing mechanisms to ensure import safety and to develop a plan to remediate any deficiencies in the system. By November the Group released its Action Plan for Import Safety.

The main thrust of the Action Plan is to seek to enlist the Chinese bureaucracy to enforce standards set by the United States Food and Drug Administration (FDA) and other federal agencies. This approach was formalized in two bilateral agreements signed in December 2007. One, between the United States Department of Health and Human Services (HHS) and China’s General Administration of Quality Supervision, Inspection, and Quarantine (AQSIQ), covers the safety of food and feed. A second, between HHS and the State Food and Drug Administration of China (SFDA), covers drugs and medical devices.

Under the first agreement producers of food for export from China will have to register with AQSIQ and allow annual inspections. AQSIQ will issue certificates to firms that meet FDA standards.

In practice this may or may not lead to the desired result. AQSIQ has long had a process of registration and certification that seeks to restrict food exports to products originating in registered plants that are certified to meet certain standards. In 2007, before the signing of the bilateral agreement with HHS, AQSIQ had registered 12,700 food producers. While this might seem impressive, it accounted for less than 3 percent of food producing firms in China. Most of the food products with safety problems imported into the United States have been imported by companies not registered and certified by AQSIQ. Since the U.S. FDA
Currently inspects less than 1 percent of food imported into the United States and does not even have inspectors at some U.S. ports, it is not clear that raising the certification standards used by AQSIQ will significantly reduce problems with the safety of food imported into the United States.

More importantly, while it undoubtedly is useful to engage the Chinese in enforcing the appropriate safety standards for their exports, it is important to recognize that the capacity of AQSIQ and particularly SFDA is quite limited. This is starkly clear in the bilateral agreement covering drugs and medical devices, which states that SFDA "will work toward a system that will enable it to certify that firms that manufacture products" for export to the U.S. “meet U.S. FDA requirements.” While the agreement envisions joint training programs that will help to build Chinese capacity, this is a long-term process and there are no deadlines for developing the certification program called for in the bilateral agreement covering drugs and medical devices. Indeed, under the current Chinese regulatory framework, SFDA does not even have the authority to regulate exports of drugs and medical devices from China. It apparently has agreed to seek this authority from the Chinese government.

At the end of the day the safety of food and other products imported into the United States is a joint responsibility of producers abroad and their governmental regulators, firms that import and sell these products in the United States, and the U.S. government. The Chinese government has responded forcefully, announcing a host of initiatives to improve food and product safety. Its capacity to fully implement these initiatives remains to be demonstrated.

Importers and sellers of Chinese products too have announced steps to improve product safety. Mattel, for example, after being forced to announce repeated recalls of faulty Chinese toys, apologized to China and to its U.S. customers, acknowledging that defects in some items arose because of design flaws rather than faulty manufacturing. And it admitted that by not checking its own Chinese subcontractors it had not fully enforced its own safety guidelines, which ban the use of lead paint. It vowed to remedy its failures.

The U.S. government, on the other hand, has focused primarily on encouraging the Chinese government to enforce stronger safety standards rather than taking stronger initiatives at home. The Import Safety Action Plan announced by the President’s Interagency Working Group on Import Safety conspicuously failed to recommend either increased inspections of imports entering the United States or increased funding for U.S. agencies responsible for safety of goods reaching U.S. consumers. Indeed the action plan argues that “our nation can not inspect its way to safety.” Since 2001 food imports into the United States have doubled, but funding for the FDA has been frozen. The attitude that increased inspections and enforcement in the United States are not important persists. An FDA commissioner in testimony before Congress in late January 2007 said the agency was not sure whether it would ask for additional funding for more inspectors or whether it would place staff in China who would be charged with building the capacity of Chinese agencies to carry out agreed upon registration and certification standards. Similarly the administration is not seeking increased funding for the Consumer Product Safety Commission. Its budget, even before correcting for inflation, is now less than half the level of 1974, the year it was created.

Thus the key question remains. Do we have the right mix of policies to improve safety of food and other products imported from China?
Chinese leaders are haunted by the fear that their days in power are numbered. President Hu Jintao, like Jiang Zemin who preceded him, knows that he lacks the personal prestige and charisma of Mao Zedong and Deng Xiaoping, the founders of the People’s Republic of China in 1949. Today’s leaders also recognize that two and a half decades of economic reform and opening to the world have radically transformed Chinese society and created latent political challenges to communist rule.

The leaders’ insecurity was sharply heightened by the events of 1989. Massive pro-democracy protests in Beijing’s Tiananmen Square and more than one hundred thirty other cities—and the differences among the top leaders over how to deal with them—almost brought down communist rule in China. Just months after that close call, China’s leaders watched with foreboding as the Berlin Wall fell and communist governments in the Soviet Union and Eastern Europe began to collapse. No wonder China’s leaders are anxious about their own political survival.

Before 1989, Deng Xiaoping and other post-Mao leaders had taken some bold steps in the direction of political reform to spur economic modernization and restore popular trust in the Chinese Communist Party (CCP). Most notably, they cut back the Communist Party’s totalitarian domination of the government and society. But this trend was halted and in certain respects reversed after Tiananmen. Party conservatives blamed the political reforms for subverting the Party’s authority and enabling the protests.

The lessons they drew from the Tiananmen crisis were that for Communist Party rule to survive, they must do three things: Prevent large scale social unrest; avoid public leadership splits that might embolden people to take to the streets; and keep the military loyal to the Party.1

Since then, Chinese leaders have sought to sustain communist rule by enhancing the system’s responsiveness to China’s increasingly diverse and pluralistic society, and managing elite politics so that divisions at the top do not mobilize opposition from below.

**Responsiveness**

Devising methods to make governance more responsive while avoiding any loss of Communist Party control is a difficult challenge. The leaders have shied away from elections that would make officials formally accountable to the public or even to rank and file Party members instead of to the Party authorities above them. Communist Party appointment of government officials at all levels—sometimes called the *nomenklatura* power after the Soviet practice—is the cornerstone of communist rule. Chinese officials and intellectuals talk a lot about democracy these days—the term was invoked more than sixty times in President Hu Jintao’s
address to the Communist Party’s National Congress last October. But they have shown no
courage to actually institutionalize it.²

China introduced elections of village leaders under Deng Xiaoping, and they have continued to the present. Deng even spoke about the ultimate goal of national elections.³ After Tiananmen, however, the efforts of political reformers to extend direct elections of leaders from the village level, which is not part of the government, to the township level, which is responsible for many key government policies such as tax collection, have been stymied by the timidity of Party leaders. As Jiang Zemin reportedly said, if direct elections of leaders in villages today lead to electing leaders in townships tomorrow, and in counties the day after tomorrow, very soon they would directly elect national leaders. “If things go like this,” he asked, “where would the Party’s leadership be?”⁴ Jiang Zemin had sought to consolidate his power in 1997 by promising the National Party Congress that he would extend the “scope of democracy” and establish a “sound system of democratic elections.”⁵ But then he and his colleagues in the Politburo lost their nerve: The Congress did not formally endorse township elections, and when some localities experimented with them, they were banned as unconstitutional in 2001. (The constitution grants formal authority for choosing township leaders to local legislatures which typically rubber-stamp the Communist Party’s nominations. The Chinese constitution, which has been revised eight times, could easily have been modified to allow direct township elections if the leaders had really wanted them.)⁶ Direct elections of county or city officials have never been seriously contemplated.

As a substitute for elections, the CCP has come up with a variety of mechanisms to allow citizens to voice their views of individual officials as part of the selection process. One method is called “open recommendation and selection” (gongtui gongxuan). Anyone already serving as an official is allowed to apply for the post and take a written examination. The top scorers are given an oral examination by a group of elite representatives, and then the top two vote-getters are recommended to the Party committee at the district or county level. Another method is to use straw polls (called “hai xuan” or “sea election”) to winnow down to the most popular individuals the list of proposed nominees passed to the upper level Party organ. Party officials, as well, are supposed to be reviewed as part of their promotion process in informal meetings of citizens. The Party wants to identify candidates with local support to make sure that its policies are smoothly implemented.

To head off social unrest, Beijing orders local officials to fight corruption, clean up the terrible air and water pollution produced by the rush to industrialization, and provide social goods like health, education and welfare. But the central leaders are continually frustrated by failures to implement these priorities at the local level. Local officials remain fixated on economic growth because the growth rate is the number one criterion for promotion, and growth is what creates jobs and other patronage opportunities. One obvious answer to the problem is to empower citizen watchdogs. But how is it possible to bring public opinion to bear on local officials without ceding the Party’s control over these officials?

To strengthen public oversight of local government Beijing has passed laws and regulations requiring public hearings to review the environmental impact of construction projects, the posting of local budgets and regulations on government websites (e-government), and open bidding for government construction contracts. In some townships, supervisory groups made up of elites holding other Party and government posts have been established to oversee government administration. And by law individuals are legally permitted to express their grievances by petitioning.⁸

Is this managed citizen-oversight an effective method of monitoring governance or a form of faux participation that will only fuel more discontent?⁹ Recent demonstrations against the construction of a highly polluting chemi-
cal plant in Xiamen and the high-speed maglev train route in Shanghai were provoked by objections not just to the projects themselves, but also to the inadequate public notification and discussion of them. The blackout of news about demonstrations also evokes a new rallying cry, “the people’s right to know.”

One way to make citizen oversight more effective would be to allow it to be collectively organized. But the Communist Party, wary of any potential organized opposition, keeps social organizations on a very tight leash. Every nongovernmental organization, including religious groups, must be registered with a government sponsor who is responsible for its actions. And the chartering of organizations focused on public policy, such as environmental protection, is strictly limited. In contrast to the tight restrictions on citizen groups, the Party facilitates the organization of state and private businesses into trade associations which lobby actively in their own interests.10

From the standpoint of China’s leaders, the mass media is an attractive alternative to organized citizen groups for monitoring government actions. The Communist Party allows the now commercialized mass media to serve as a watchdog over local politicians. A popular nationally televised program on China Central Television called Focus showcases government responsiveness by investigating failures on the part of local governments and reporting on how they are remedied almost overnight as a result of the publicity. The State Environmental Protection Agency actively calls on the media to help it expose local politicians who neglect environmental protection. And the Party censors have opened up the issues of food and pharmaceutical quality for investigative journalism because top down methods so clearly are inadequate. Because the editors of almost all newspapers, magazines, television stations and news websites are hired and fired by government or Party agencies, it’s less risky to empower a media outlet than a citizen association. Journalists have discovered that exposing malfeasance of local officials sells newspapers and is politically permissible … if the abuses are in localities other than where their own publication is based. But when the media’s monitoring of outside localities (yidi jianidi, supervision in a different place) started to endanger the careers of provincial and municipal officials, these officials got the Politburo to outlaw the practice in 2005. At present, journalists find that investigations of abuses outside their own area won’t get them in trouble so long as they limit their exposés to scandals at the county level and below.

Leadership Politics11

After Tiananmen, China’s leaders were determined to never again let their internal disagreements spill out into public view. They had learned their lesson: If they don’t hang together, they could hang separately, as the Western saying goes. If the leadership group remains cohesive despite the competition that inevitably arises within it, then the Communist Party and the security police can keep social unrest from spreading out of control and the regime will survive. Unless people receive some signal of “permission” from the top, protests are likely to fizzle out before they grow politically threatening. But if the divisions among the top leaders come into the open as they did in 1989, people will take to the streets with little fear of punishment.

Beginning with Deng Xiaoping, CCP leaders have tried to reduce the risk of destabilizing leadership splits and the rise of another tyrant like Mao Zedong. They regularized leadership competition by introducing fixed terms of office, term limits, and a mandatory retirement age to regularize leadership competition. Leadership politics have become more institutionalized and less volatile. The oligarchs do everything they can to prevent divisions among themselves. The practice of having the top leader hold three key positions—general secretary of the CCP, president of the PRC, and chairman of the Central Military Commission is designed to prevent destructive cleavages among the leaders.
Leadership succession is the Achilles heel of authoritarian governments, the moment when it is most difficult to keep the competition for power within the black box. When Jiang Zemin, having reached the age of seventy-seven, retired as Communist Party general secretary (2002) and President (2003), it was the first time that a leader of a large communist country had ever peacefully handed down power while still alive. Jiang managed to hang on to his job as chairman of the Central Military Commission because it did not require retirement at seventy. But without the institutional authority of the top Party post, Jiang’s influence diminished, and two years later in 2004 he retired completely. During the two years when Jiang and Hu shared power, subordinate officials felt uneasy. The last time China had two different voices coming from the leadership they caused the near disaster of the 1989 demonstrations. Anxious to prevent any threats to stability, senior and retired leaders reportedly convinced Jiang that the best way to preserve his legacy was to retire completely.

At the Communist Party National Congress in October 2007, the current leaders faced the challenge of coming to agreement over the next generation of leaders, in particular who would succeed Hu Jintao as China’s top leader five years later in 2012. Although the formal authority to choose China leaders—the Politburo, Standing Committee of the Politburo, Secretariat, Central Military Commission, and general secretary—rests with the 371-member CCP Central Committee, the incumbent leaders hammer out the slate in secret.

Hu Jintao lacked the power to hand-pick his own successor (in contrast to Mao, Deng, or past Mexican presidents). He was forced to choose an individual who would be acceptable to the other oligarchs. Everyone in the collective leadership wants to avoid the risks of an internal power struggle. One way of settling the issue would have been to let the Central Committee hold a genuine competitive election with open nominations, as Vietnam does now. But the leaders were not prepared to give up their monopoly of power and make themselves accountable to the larger body.

In the lead-up to the Party Congress, policy advisors and other experts publicly promoted the notion of intra-party democracy as the first step toward fuller democracy. They had high hopes that the Congress would provide the occasion for Hu Jintao, having consolidated his authority during his first term, to finally emerge as the genuine political reformer they believed him to be. In the end, however, they were disappointed because despite all the talk, the actual changes to institutions and practices within the CCP were trivial.12

Instead of letting the Central Committee exercise its full authority over the succession, the incumbent leaders cautiously adopted a half-way measure reminiscent of the way they have handled local elections—trying to be responsive without risking the loss of control that formal accountability would imply. Four months before the Party Congress in June 2007, they held a special expanded meeting of the 16th Central Committee. Hu Jintao gave an important speech in the morning to try out the themes he planned to present at the upcoming Party Congress, and in the afternoon the body held an informal straw poll (some people have called it a hai xuan or sea election similar to the informal votes taken at the village and township level to determine the popularity of nominees) to consider the names of people who might be nominated to the 17th Central Committee. Reportedly Xi Jinping’s name rose to the top which helped the oligarchs converge on him as the likely heir apparent.13

Achieving consensus among the oligarchs required a package deal. Four new faces were promoted to the Standing Committee of the Politburo. Xi Jinping, who came out on the stage first in the position of potential successor, does not have particularly close ties to Hu or to anyone else for that matter. Hu’s presumed favorite, Li Keqiang, had to settle for the number two position. Although Li or someone else might challenge Xi for the number one position over the next five years—Xi’s position may
not be all that solid in view of the fact that he has not yet been given a position on the Central Military Commission—an open contest is something that all the leaders have an interest in avoiding.

We know very little about the political views of this new generation of leaders. Xi Jinping or Li Keqiang may favor some political reform but they have hidden it up to now. Compared to the previous generation of technocrats, more of the new generation have been educated in law, management or economics; but their graduate degrees were obtained in part-time executive programs and their knowledge may not go very deep.

Looking Toward the Future

Despite the leaders’ collective interest in preventing open splits, individual politicians have moments of temptation when an interest in acquiring more power for oneself might lead one to exploit a crisis situation and reach out to mobilize a following of ordinary citizens or rank and file Party members. Large protests increase the risk of a split by showing leaders that a following is already in place. Social unrest actually can create schisms at the top. The danger is not a matter of the particular personalities in the oligarchy at any one time, but is built into the structure of authoritarian politics. Changes in the mass media heighten the risk of the public being drawn into elite disagreements. Leadership splits telegraphed to the public over the Internet have triggered revolutionary upheavals in other authoritarian regimes. In a society undergoing explosive change, political outcomes are unpredictable because the political game is evolving too. Every day new opportunities and challenges present themselves to ambitious politicians in China. Keeping leadership competition under wraps is becoming increasingly difficult as the media and Internet compete for audiences by testing the limits of what they can report.

But for the near term, the important news is that China’s oligarchs have figured out a way to bargain out their individual interests in a way that allows them to hang together and maintain the closed politics of the Communist Party. The intense competition among them hasn’t yet forced them to open up the process to broader participation within the Communist Party (as Vietnam has done) or to the society at large. We should plan on dealing with China’s communist leaders for some time to come.

As a rising power that wants to reassure the world that it has benign intentions and isn’t a threat, China cares more about its international reputation than any other country in the world today. Chinese policy makers are very attentive to our views of its international behavior. When we criticize their actions in Africa, they start to change them. But American calls for political reform in China are likely to fall on deaf ears or, worse, provoke a popular nationalist backlash.

One way of getting leverage on China’s stalled political reforms is to press on issues such as food and pharmaceutical safety where our own interests are clear. The Chinese recognize our right to demand better systems of regulation and transparency to guarantee the quality of what we import from China. China’s hierarchical system has proven inadequate for monitoring the behavior of local officials and firms without the oversight that real elections and a free press would provide. International demands for improved monitoring of exports could reinforce domestic demands in China for improved democratic accountability.

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1 This essay will address only the first two. For a fuller discussion see Susan L. Shirk, *China Fragile Superpower* (New York: Oxford University Press, 2007).


6 Lianjiang Li predicts a possible future clash between local legislatures who have the formal authority to select township leaders and the CCP organization bureaus that actually make the selection decisions. One way to resolve such a conflict would be to introduce direct township elections. Lianjiang Li, p 721.


8 Ibid.

9 Some Chinese officials have enthusiastically embraced the “deliberative democracy” approach developed by American political scientist James Fishkin which involves communities discussing in town meetings how to spend their budgets instead of electoral representation. Ethan J. Leib and Baogang He, eds. The Search for Deliberative Democracy in China (New York: Palgrave Macmillan, 2006).


11 This section draws on material in the author’s book, China Fragile Superpower (New York: Oxford University Press, 2007), pp 35-78.

12 Local Party committees will start taking votes on major issues and appointments; the Politburo will report regularly to the Central Committee and local standing committees will do the same to local Party committees; local Party congresses will meet more often instead of just to select Party committees. The tension between top-down control and bottom-up responsiveness within the Party was reflected in the proposal that “candidates for leading positions in primary Party organizations are recommended both by Party members and the public in an open manner and by the Party organization at the next higher level.” Xinhua, November 1, 2007, http://www.china-embassy.org/eng/gyzg/t377262.htm.

Historical Context

China’s military modernization is recent, dating from the middle of the 1990s. The People’s Liberation Army (PLA) had been a large infantry force, supported by a small navy and obsolete air force, with a small arsenal of nuclear weapons. The Deng Xiaoping reforms of 1978 relegated military modernization to fourth place, behind agriculture, industry and science and technology. As late as 1999, when I met with Chi Haotian, the long-serving Minister of Defense, he bemoaned the lack of priority and resources for the PLA.

Initial PLA Modernization Program

However General Chi was being somewhat disingenuous. Even without funding increases, the PLA had begun fundamental structural changes in the mid-1990s. While defense was the fourth of four modernizations, at least it was on the list, so PLA leadership was obligated to do what they could with their own resources. The results of the First Gulf War in 1991 had been an unpleasant jolt. Chinese military experts had confidently predicted heavy going for the American-led coalition against the battle-tested, Soviet equipped Iraqi armed forces. It was clear that the People’s Liberation Army was falling behind world military standards.

The PLA started with the actions it could undertake on its own, without additional funding, or modernization of its “software:” force structure, doctrine, funding, logistics, education and training. Its new vision became “local wars under modern high technology conditions.” This awkward phrase means the PLA would be smaller in numbers, but better trained, more mobile and balanced, equipped with precision weapons, space surveillance and communications, information networks, and other high technology military systems. The Chinese defense strategy would shift from defeating invaders through sheer numbers and China’s strategic depth to winning confrontations or conflicts quickly on its periphery—its land borders with India, Russia and Vietnam, and its maritime borders with Taiwan and Japan. As it was described several years later in the first Chinese military white paper, published in 2002: “…the Chinese military persists in taking the road of fewer but better troops with Chinese characteristics, pushes forward the various reforms in response to the trend in military changes in the world, and strives to accomplish the historical tasks of mechanization and IT application, thereby bringing about leapfrog development in the modernization of the military.”

One of the early programs was the elimination of PLA businesses. Serving officers had run farms, factories, concessions, hospitals and even night clubs. The products and profits went to pay military expenses, with a portion lining the pockets of many officers. As the PLA relinquished control of businesses, the Chinese
government increased its central budget to offset the lost revenue.

Another generally successful program has been the reduction of PLA end strength. In the last decade, manpower has been reduced by almost half. The paid off soldiers are treated somewhat better than are the millions of employees of state-owned industries (SOEs) with pink slips. The PLA is responsible for providing these officers housing and jobs, and the soldiers jobs. Often the PLA has discharged this responsibility simply by shifting it to local governments. Nonetheless it has been a large and continuing administrative and financial burden. Although the military finance mechanisms are complex, the result of its personnel reductions has been to free up resources for the PLA to spend on the training and equipping the smaller remaining force.

Another key initial focus area has been training. In the past the PLA training program, like that in most authoritarian countries, featured set-piece exercises with simple objectives, heavily rehearsed, with predictable and well rewarded high scores. This type of training was also useful to show high-level visitors. In 2000 I was treated to the largest combat demonstration shown to an American military visitor to that point. It was a performance, not a training exercise, obviously following a practiced time-based script. PLA training is heavily reported in the military press, and now includes sophisticated critiques of tactical training that point to shortcomings, emphasize the importance of realism, of free-play, of honest evaluation by observers, and continual improvement.

However, other aspects of these “software” modernization programs undertaken by the PLA have had more mixed success. While realistic training has increased at the unit level, it is less clear if these principals of realistic training have been applied to the training of higher-level staffs, and have been paired with models and simulations to drive realistic staff exercises and a system for capturing the lessons learned, and applying them widely throughout the forces. This is an important shortcoming, as the PLA has had no combat experience since 1979, and its senior leadership has never commanded under the stress of actual conflict.

Another clear deficiency in PLA modernization is in the area of joint operations. My discussions with Chinese military leaders in 2001 made it clear to me that PLA units from different services are given their own areas of the battlefield, and do not operate together at the same time in the same space. This is a severe limitation on the effectiveness of modern military forces, especially in air and maritime operations.

**Funded Modernization Program**

Around 2000 the PLA began to receive budget increases. The size of the increases, how they have been spent, and their purchasing power are all matters of debate and uncertainty. It is clear from the results that there is more spending on equipment, including a complete replacement of nuclear forces, an expansion of most missile systems, and many increased navy and air force programs. There has been a roughly 50% increase in pay for PLA officers, to attempt to keep them from leaving the service for better paying civilian jobs. Training budgets have also increased. The result has been a better-equipped, higher quality and better-trained PLA.

What is uncertain, and of most concern, both to the United States and to China’s neighbors, are China’s motivation, purpose and final objective. Are these military budget increases the initial down payments on a secret Chinese plan to develop the military force to challenge the United States, first in Asia, and eventually worldwide? Alternatively, are they, as the Chinese claim, the long overdue payments for an appropriate defense capability of a country that will soon have the second largest economy in the world, a country that has been invaded and administered by outside powers within the past century?

My own judgment is that the Chinese military budget increases are primarily driven by short-
term considerations, by a collective government decision to allow military modernization to keep pace with the overall economic development of the country. Whether they continue to develop at the current rate for a prolonged period, making the resources available to the PLA to build and maintain a modern expensive force structure that can challenge the United States, is unknowable. It will depend both on developments within China, and on developments in the international political scene.

There is no doubt that the PLA leadership itself is continually pushing for more resources, both for the missions it has been currently assigned, and for the more expansive missions it would like to have.

**Missions of the People’s Liberation Army**

China has published authoritative white papers about its military forces, every two years since 1998. The 2002 White Paper established five “goals and tasks” for the PLA:

- To consolidate national defense, prevent and resist aggression.
- To stop separation and realize complete reunification of the motherland.
- To stop armed subversion and safeguard social stability.
- To accelerate national defense development and achieve national defense and military modernization.
- To safeguard world peace and oppose aggression and expansion.

The first and third are of little concern to the United States; it is the second and interpretation of the final two that matter to Americans—do they imply a future modernized PLA that will “safeguard world peace” on Chinese terms?

The 2006 edition of the White Paper assigns the individual PLA services goals that seem more aggressive than the 2002 version: “The Army aims at moving from regional defense to trans-regional mobility, and improving its capabilities in air-ground integrated operations, long-distance maneuvers, rapid assaults and special operations. The Navy aims at gradual extension of the strategic depth for offshore defensive operations and enhancing its capabilities in integrated maritime operations and nuclear counterattacks. The Air Force aims at speeding up its transition from territorial air defense to both offensive and defensive operations, and increasing its capabilities in the areas of air strike, air and missile defense, early warning and reconnaissance, and strategic projection. The Second Artillery Force aims at progressively improving its force structure of having both nuclear and conventional missiles, and raising its capabilities in strategic deterrence and conventional strike under conditions of informationization.”

These phrases can be interpreted as the logical elements of a robust defensive capability and a joint force that can threaten Taiwan. Alternatively, it is easy to interpret them as elements of long-range projection capability for China in the future to coerce its neighbors, support its positions in regional or more distant crises, and even fight wars well outside its borders. To understand what is real and what is aspirational, it is necessary to look at the actual military capabilities of the PLA, especially for missions that affect American interests.

**Nuclear Deterrence**

China is modernizing its relatively small and increasingly obsolete strategic nuclear forces. The modernization program overcomes the increasing vulnerability of its fixed, liquid-fuelled arsenal. The two primary development programs are road-mobile solid-state intercontinental missiles and a second-generation submarine-launched missile system. Both missiles will have maneuverability and penetration aids to overcome missile defenses. After an internal debate that occasionally leaked out into public, China has decided to continue its doctrine of “no first use” of nuclear weapons.
Overall, China’s nuclear forces in the future will play the same role they have in the past, a limited retaliatory force to deter attacks by other countries.

**Homeland Defense**

China takes its own defense seriously. Within the memory of its current leaders, it has fought major engagements with the Soviet Union, India and Vietnam. Their immediate predecessors fought full-scale wars with Japan and an American-South Korean army. The PLA has traditionally been a regionally based defensive force, with most of its officers and soldiers serving their entire careers in a single region. The PLA is developing greater mobility for its ground forces, but it retains strong local forces in its border military regions. As it has reduced personnel and modernized its weapons systems, the PLA has spread the modern equipment and best units around the military regions. It appears that China intends to keep modernized forces at home throughout the country for strong border defense.

These developments in its defensive capability are of little concern to the United States.

**Coercion and Conquest of Taiwan**

China openly threatens Taiwan with attack if it asserts independence. The PLA has been given the missions of punishing Taiwan if it asserts independence and developing the capability to take Taiwan by force, completing the historic mission of unifying all of China. Since the Taiwan crises of 1996, China has become more concerned about Taiwan moving toward independence. PLA leaders have successfully played on this concern to argue for greater funding. A large part of the PLA budget increase has been to increase its capability to subdue Taiwan and to raise the cost of U.S. intervention to support Taiwan.

China has concentrated its Taiwan-focused modernization in three areas: surface-to-surface missiles, submarines and air defenses. These forces increase its ability to punish Taiwan, and to damage U.S. maritime and air forces supporting Taiwan, but do not constitute a capability to conquer Taiwan. In fact, there are major deficiencies in China’s amphibious and air assault capabilities, most notably in amphibious lift. While China could land relative small numbers of forces on Taiwan if it were lucky or achieved surprise, it has not developed the capability to overcome mobilized Taiwanese defenses. It appears that China is pursuing the capability to prevent Taiwan from asserting its independence, and to coerce it into political accommodation by the threat of punishment, but is not developing the capability to reunite Taiwan to China by a forceful invasion.

Taiwan itself has finally begun to increase its defense spending. The United States is focusing its substantial maritime and air capabilities to intervene in a Taiwan contingency, and has the capacity to outpace any Chinese developments.

**Long-Range Power Projection**

It is this mission area that is of most concern to the United States over the long term. China’s army-dominated leadership has a strong tradition and defensive mindset of keeping its forces at home. China’s air force, although it is building advanced Russian and indigenous advanced fighters, still concentrates on air defense and support of ground forces. In contrast, like Navy leaders everywhere, China’s admirals desire a bluewater, global capability, both to defend their maritime frontiers at greater distances, to show the flag in support of their country’s global interests, and to provide a means for fighting distant military actions that support China’s interests. They also play to the patriotic desire of Chinese for the prestige value of aircraft carriers, the ultimate symbol of advanced military capability.

The actions of the Chinese government, which has to pay the bills for the PLA, have fallen short of Chinese naval aspirations. The primary overseas deployments of Chinese forces have been in UN peacekeeping forces, which have increased from negligible numbers in 2000
to several thousand now. Chinese naval deployments have been largely symbolic—goodwill voyages of small numbers of surface ships, and probing missions by Chinese submarines in the East China Sea.

China has yet to undertake the programs and actions to project and sustain significant military forces at a distance—naval battlegroups that can defend and sustain themselves away from land support; amphibious shipping; underway replenishment shipping; overseas bases or access rights for logistics resupply; worldwide surveillance and reconnaissance capabilities. While China could cobble together a task force to intervene in, for example, a confrontation in Africa, if there were no opposition, it seems to have no current plans for a serious intervention capability. It takes years to develop a power projection capability, giving the United States and China’s neighbors ample warning to react.

Space Operations

China is developing serious space capabilities, both civilian and military. It seems to be following exactly the path blazed by the United States and the Soviet Union half-a-century ago: manned civilian space exploration; manned and unmanned scientific research in space; civilian and military use of space for communications and geolocation, military use of space for intelligence and surveillance, and counter-space research and development to deny potential adversaries the use of space.

The Chinese anti-satellite (ASAT) test in January 2007 raised major questions about China’s intentions for space, especially against the backdrop of its long-time and strongly expressed positions in the Geneva talks against extending military operations to space. The technological reality is that interfering with or destroying another country’s satellites is easily within the capability of a country that can launch and operate its own satellite constellations, as does China. The real question for China is whether it would benefit in the long-term in a military competition with the United States in space. Right now, the United States uses satellites far more than China for both commercial and military purposes. In the future, China will become increasingly dependent on satellite systems both for its economic development and military capability, and will have the same vulnerabilities as the United States. Clearly surprised by the international reaction to its ASAT test, China has declared a moratorium on future tests, and is reconsidering its policies and programs. There are strong arguments to be made that it is in China’s interests for space to be a region open to use by all countries, rather than an area of military competition, and China may come to that decision. If China takes a different course, then the United States will need to undertake a strong program of its own to harden our satellite systems and put back into service systems to degrade China’s.

Summary

The challenge for American leadership in dealing with China is complex and sophisticated. While expecting good relations with China and working with Chinese leaders on areas of mutual interest and advantage, Americans need to call China on its actions that violate international norms and undercut American interests, and periodically evaluate the overall balance in the relationship to ensure it is positive. Finally, the United States needs to maintain and enhance its own national strengths in case antagonistic relations develop with China.

In evaluating China’s military actions, it is most important to make judgments based on real military capabilities, not on blue-sky projections of individual Chinese actions. The Chinese listen carefully to what American leaders say and watch what the United States does, and my experience has been that they take seriously actions that are explained in reasoned terms.

China is pursuing a substantial and complex military modernization program. It has already improved its ability to prevail in any disputes with its neighbors; it has substantially raised the costs to Taiwan of pursuing independence,
and the costs to the United States of supporting Taiwan if we were to intervene in any Taiwan crisis. For the foreseeable future the United States would prevail in an intervention; China’s ambiguous words, secrecy and some actions have raised suspicions it may be developing military force for use in the East Asia region and further, although the PLA has not developed nor demonstrated even the rudiments of the actual capabilities to do so.

Chinese military developments so far could provide the basis for a cooperative relationship with the United States in the many areas in which the two country’s interests run parallel: the free flow of oil from the Middle East; a peaceful transition in North Korea; the suppression of global terrorism; suppression of nuclear proliferation, drug trafficking and other smuggling activities. On the other hand, these same developments could form the basis for military confrontations in East Asia or elsewhere. It is in the American interest to work with the Chinese on common interests, while maintaining its alliances and partnerships in Asia, and ensuring that its maritime and air forces remain powerful, modernized and forward deployed in the Western Pacific.
The Nexus of Energy, Global Warming, and Environmental Concerns: Opportunities for U.S.-China Cooperation

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As global climate change and rising demands for oil, natural gas, and coal resources attract growing worldwide attention, the powerful new influence that China now exerts commands a growing share of the world’s speculation and concern. The rapid pace of China’s economic growth staggers the world’s imagination, and its rising significance as an environmental actor magnifies the stakes in managing a massive global transition toward sustainable growth.

In just the past few years, the world’s most developed nations have begun to grapple with the urgent challenges posed by climate change. Many have developed policies to dramatically reduce the greenhouse gas emissions their economies produce. Yet some critics wonder whether such changes can really matter unless China also commits itself to a parallel and equally aggressive strategy to reduce its carbon footprint.

What is less well understood is the dramatic progress China is already making, quietly, even as its economy roars along. Though it still remains by any measure a developing nation, Chinese officials have moved with impressive speed to acknowledge the nation’s energy challenges and put in place new programs to slow the pace of its energy growth and carbon emissions.

Understanding the challenges China faces requires acknowledging not only the unprecedented nature of China’s economic transformation in the last three decades but also the immense dimensions of the canvas on which this saga has been playing out.

China’s Transformation

A land containing four times the population of the United States, China has a robust economy that consistently expands by ten percent each year, more than triple the pace of the U.S. and European economies. In a little more than two decades, a population nearly equal to that of the entire United States—some 300 million people—has risen from poverty to the trappings of middle-class economic status. Another 300 million loom just behind them, eagerly awaiting their turn to move up the economic ladder.

As China’s leaders cede greater control over the economy to private entrepreneurs and to the opportunities they see being created by the marketplace, major flows of investment and technology from abroad have given China the capabilities and resources to emerge as the world’s single largest factory floor. Combining advanced technology with limitless supplies of labor, China’s exports to the world already exceed $1 trillion per year. Toys and textiles, cameras and computers, China is now among the world’s top producers in these and hundreds of other goods.

This colossal increase in industrial production has not only made jobs available to millions of young Chinese streaming out of rural China to work in its factories, it has significantly
benefited the world’s consumers. China’s growing manufacturing sector has lowered prices for manufactured goods and, until recently, dampened inflation. Yet the robust expansion of China’s manufacturing economy and its rising share of international trade, which is in large part driven by international investors, has also increased China’s need for capital equipment, raw materials, and, especially, energy. Today for example, China consumes more than 31 percent of the world’s steel and even higher percentages of iron ore and coal. It has become the largest market for cell phones, fertilizer, grain, and coal. China puts two new power plants on line each week. Yet electricity consumption per capita is still very low, and periodic power shortages in selected areas across China remain commonplace.

This rapid growth has transformed China into the world’s second largest user of oil after the United States, requiring more than seven million barrels of oil per day (mb/d). By 2020, that demand is forecast to exceed 16 mb/d per day.

Rather abruptly, the world is being forced to discover how to accommodate China’s accelerating economic engine—an engine it helped design, engineer and construct. After all, roughly one-third of the total energy consumed in China is used to produce the goods that are then exported to wealthier consumers around the globe. Thus, a significant amount of the pollution and carbon dioxide being put into the air by Chinese factories today represents emissions that once were generated by factories located in Pittsburgh, Gary, and Toledo, as well as in Germany’s Ruhr Valley.

So as China rushes to re-enact the industrial revolution that led the West to wealth, the challenge today is for China to find a way forward in a carbon-constrained world. Rather than simply follow the path of 20th century development, China will have to break a new path of development that ensures its growth is cleaner, uses energy more efficiently, and produces less carbon dioxide.

**China’s New Clean Energy Policies**

China’s remarkable requirements for new sources of energy and raw materials sometimes masks the fact that the Beijing government has already put into place a suite of programmatic clean energy policies that translate into the world’s most ambitious target for cutting emissions of carbon dioxide.

For example:

- China has established a renewable energy law that mandates that by 2020, fifteen percent of the nation’s energy supplies will come from wind, biomass, solar and small hydropower. In 2006, the first year after China issued this renewable energy law, installation of wind power facilities actually doubled, and today advanced design windmill projects are readily visible in places like the vast Gobi Desert in western Xinjiang province. By 2007, China had already met its 2010 target for wind power development, a full three years ahead of schedule.

- China has set a goal of reducing its energy intensity by twenty percent between 2005 and 2010. By 2010 China hopes to reduce by 1.5 billion tons its production of CO2, a target five times as ambitious as the plan announced by the European Union under the Kyoto Protocol and almost ten times more aggressive than the goals announced by the State of California, the most rigorous of U.S. goals.

- It has also targeted for special scrutiny the nation’s largest industrial plants, dominated by state-owned enterprises. The nation’s largest 1,000 enterprises, which collectively consume one-third of the nation’s total energy, have all signed on and committed themselves to reduce their energy use. This program alone will reduce China’s greenhouse gas emissions by 250 million tons a year by 2010.

- China has also established extensive new efficiency standards for consumer home
appliances such as refrigerators and clothes washers, as well as energy codes for commercial and residential buildings.

• The rapid pace of automotive sales in China and the accompanying rise in oil consumption have also masked the fact that the nation has proven itself more aggressive than the United States when it comes to demanding higher fuel efficiency for its automobiles. The U.S. Congress recently passed new rules mandating that American automakers raise average fleet mileage to 35 miles per gallon in 2020. In 2008, Chinese cars already have to meet a 36 miles per gallon standard.

Taken together, these measures make China a clear leader in formulating sustainable energy policies among the developing nations, if not the world. Yet despite these significant achievements, and the recognition by the central government that China needs to search for a more energy and resource-efficient development path under the rubric of the “scientific development perspective,” it is unrealistic to expect a populous nation still in the early stages of industrialization such as China to reduce in absolute terms its carbon footprint in the near future.

China’s Energy Challenges

Today China’s per capita energy use remains only one-eighth the level consumed by Americans and one-quarter the usage of residents of the European Union. And from a historical perspective, China’s cumulative contribution of carbon dioxide since 1750 has equaled only 8.2 percent of the world’s total, while the United States produced an estimated 27.5 percent of total CO2 now in the global atmosphere.

As millions of Chinese peasants migrate to large cities in the coming decades, however, per capita energy consumption could easily double or triple, since the footprint of China’s energy use is directly correlated to the delivery of basic services such as lighting, refrigeration, air conditioning, and the power needed to run the factories that make all the products Americans and Europeans avidly consume. Rising income is also fueling the sale of automobiles in China, and by 2020, China may well have 140 million cars on the road.

So the consequences, should China and the rest of the developing world simply follow the traditional path of industrialization and modernization, would be truly and literally breathtaking. If every one of China’s 1.3 billion people were to consume as much energy as Americans do today, China’s carbon dioxide emissions in 2020 would be 22 percent higher than what the entire world currently produces.

As the world begins to comprehend the unprecedented energy challenges that now confront China, China’s own leaders have begun to confront a new challenge: tapering off of its energy efficiency gains. For some twenty years, China consistently demonstrated a record of steady improvement in its energy efficiency. From 1980 to 2000, China’s economic activity grew twice as fast as its energy consumption. This was a remarkable achievement, considering that it is more typical in most developing countries that energy grows faster than economic activities.

But now that impressive rate of progress has begun to flatten out, as the composition of the nation’s investment pattern has changed. A surge of new investments in heavy industries like steel, aluminum and chemical manufacturing to support China’s urbanization and infrastructure development, as well as exports of consumer products to the world, has created enormous demand for new energy sources. This helps explain why China added 90 gigawatts of electrical generation capacity in 2007, the third year in a row in which the nation increased its power output by more than the total generating capacity of Great Britain.

The concern is that without deeper levels of investments in energy efficiency, China’s energy intensity will level off. Steel and aluminum works, chemical manufacturing and other energy-intensive heavy industries will likely con-
continue to replace subsistence agriculture as the most significant engines driving China’s growth. Likewise, Chinese peasants will continue to stream out of rural regions to big cities, and further push up demand for the steel, cement, and other industrial products needed to build the high-rise apartments and urban infrastructure projects this population will require. Amid lucrative opportunities for rapid-fire growth and wealth accumulation, there is also concern that government incentives for improving long-term energy efficiency may seem less attractive. In fact, China has fallen behind its 20% energy efficiency target in the last two years.

The Role of Coal

Coal continues to supply 70 percent of China’s total energy needs, and this reliance is not likely to change in the short-term because Chinese coal is cheap and abundant, despite its negative impact on air quality, human health, and climate change. In an age when concern over CO2 emissions is growing around the world, the fact that China’s coal use has nearly doubled since 1996 naturally triggers global concern. The International Energy Agency, which predicted as recently as a few years ago that China’s carbon emissions would not reach those of the United States until 2020, now thinks China has already taken the lead.

Yet even if it were feasible for China to immediately replace coal as a primary energy source and dramatically increase its reliance on oil and natural gas, the pressure on global energy markets would likely drive world prices even higher than they are today. It is clear that greater investment is urgently needed to help China develop cost-effective methods to use coal more cleanly, through, for example, gasification and carbon capture and storage (CCS)\(^2\). Collaboration between the U.S. and China in accelerating the adoption of such technologies could be mutually beneficial, since the U.S. is equally abundant in coal reserve as well.

Collaboration for a Common Future

The challenges China faces today are daunting. Never before has a nation starting off from such a low level of development ever attempted to modernize so quickly, even as it is being asked to make fundamental changes in its growth strategy to accommodate the globe’s looming environmental challenges. There is no precedent to follow. There are no leaders to copy, few “off the shelf” technologies to appropriate. Instead, China will by historical circumstances be forced to become a global trailblazer at the frontiers of sustainable development.

Encouragingly, China has recognized that it can no longer follow the traditional “development first, environmental protection later” approach, and with significant assistance from outside, is seeking pragmatic solutions that will allow it to continue to develop in a manner that is both resource-efficient and more environmentally friendly.

These measures include stricter enforcement of energy codes for new buildings; tighter efficiency standards for appliances; further strengthening of fuel economy standards for motor vehicles; investment in mass transit alternatives to private vehicles; green-design principles for new cities; development of renewable energy sources; and technologies that would capture and store carbon dioxide from coal.

To succeed, such policies will require strong new incentives as well as stiff penalties to force compliance. Ironically, China’s shift away from a centrally-planned economy has seriously diluted the effectiveness of central government mandates, especially those on energy efficiency and environment. A temptation to “get rich quick” challenges enforcement regimens in such a large and diverse nation where implementing national goals at the local or provincial level can often prove difficult.

In a society where the “rule of law” remains weak, strengthening the institutional capacity of relevant regulatory agencies, which are seriously understaffed and underfinanced in
relation to the scale of energy and environmental challenges confronting China today, will remain a top priority for those hoping to improve energy efficiency and environmental protection in China.

Fortunately, this is an area where the U.S. has had a lot of experience. Many states in the U.S. have successfully implemented strong energy efficiency and renewable energy programs in the utility sector with long-term management and funding mechanisms. The U.S. has also had a long history of using market-based solutions to achieve clean energy and environmental goals. By sharing our lessons in building regulatory mechanisms and the use of market-based instruments with policymakers in China, the U.S. could have a very positive influence on China’s energy and environmental choices.

Given the critical role of coal in our energy and climate security, it is imperative that the U.S. and China, both large coal users, start to collaborate on a zero-carbon coal program. Such a program could include joint research and development (R&D) activities as well as incentives to accelerate the deployment of such technologies. The size of our markets for such technologies, combined with clear policy incentives, could significantly accelerate the innovation and cost reduction for low-carbon technologies such as gasification and carbon capture and storage.

In the interdependent world in which we live today, we all share a stake in China’s realizing a sustainable development path. Our futures are intrinsically connected, and it is in our common interest that we assist in China’s transition. Moreover, as it casts for new and unexpected solutions to these imposing challenges, China may well develop its own suite of innovative policies and technologies that could benefit the world.

1 Energy intensity is measured as a ratio of energy use over GDP.

2 Gasification is a process that converts carbonaceous materials, such as coal, petroleum, or biomass, into a mixture of gases, which makes it easier to separate or capture and store CO2 released in the process.
U.S.-China Relations

CONFERENCE PARTICIPANTS

Lanai, Hawaii
March 24 - 30, 2008

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Representative Mike Honda
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U.S.-China Relations

CONFERENCE AGENDA

Lanai, Hawaii
March 24 - 30, 2008

Economic Issues in U.S.–China Relations:
Currency Reform, the Trade Deficit, Debt, Food and Product Safety
Nicholas Lardy, Peterson Institute for International Economics

Discussion Questions:
• What are the origins of the U.S. trade deficit with China, where does the Chinese trade surplus fit in with the U.S. deficit globally and in Asia, and what is the package of “policy fixes” needed to effectively address this set of issues, including revaluation of the Chinese currency? Which of these fixes could be advanced by Congress, which by the Chinese, and which by the broader international community?
• How important is China’s possession of U.S. debt instruments to the U.S. financial position, to the determination of U.S. interest rates, and what can be expected in terms of China’s future acquisition of U.S. debt?
• The food and product safety issues call attention to the complexity of the global supply chain and China’s insufficient regulatory system. What is known about the underlying regulatory system in China, inspection and control within the multinationals that export from China, and what are the responsibilities of U.S. inspection institutions? Are there any congressional fixes here?

Prospects for Political Liberalization in China and China’s Political Leadership
Susan Shirk, University of California at San Diego

Discussion Questions:
• In 1989, there was serious discussion of political system change in China, discussion that was abruptly curtailed after the June 4th violence. Since that time, what, if any, discussion has rekindled concerning political change there?
• Who are the Chinese leaders, what is known about them, and what does their ascent to power signify? What are the policy implications for the United States and what do they signify in terms of the prospects for future political liberalization?
• Looking at political institutions, what kinds of experiments are going on in the realms of governance in localities, within the Communist Party itself, and with respect to potentially important organs such as the National People’s Congress? Are there positive changes or trends here for which U.S. policy might be relevant?
Before Dinner Discussion: Post-Election Analysis of the Taiwan Election  
Remarks by Bi-Khim Hsiao, Democratic Progressive Party, Taipei  

China’s Military Modernization on Land and Sea, and in Air and Space:  
Relevance for U.S. Policy  
Dennis Blair (former Commander of the U.S. Pacific Command)  
Dickinson College  

Discussion Questions:  
• Not long ago analysts of the Chinese military were saying that the modernization of China’s military faced a long, difficult road to become a fully modern force. How far has China advanced in the land, sea, air, and space domains? How important is this for China? What are the implications for U.S. policy?  
• With reference to space, what are both the civilian and military motivations for the Chinese space effort? How large and effective is that effort to date and what are the plans for the future? What are the implications for U.S. policy? What relevance was China’s January 2007 anti-satellite test?  
• There are more Chinese forces (usually under UN auspices) around the world and engaged in exchanges and joint exercises with other militaries. What is the purpose of this interaction? Is the Chinese military becoming more transparent? What are the implications for U.S. policy and congressional action?  

The Nexus of Energy, Global Warming, and Environmental Concerns:  
Opportunities for U.S.–China Cooperation  
Lin Jiang, The Energy Foundation  

Discussion Questions:  
• What are the dimensions of China’s growing impact on the global environment and the global energy system and how does this compare to the other major sources of global impact along various dimensions?  
• How do Chinese leaders define their domestic and international environmental problems and responsibilities, and what actions are they taking in light of this analysis? What are the implications of these policies in the long run?  
• In both the energy and the environmental areas, are there domains in which U.S.-China cooperation would be a “win-win” and what avenues are available to the U.S. Congress to facilitate such cooperation?