**A weekly report on U.S. think tanks on China issue -** March, 8th, 2016

Hyun-joo Lee

**Executive summary**

As for this week, most publications by main think tanks in the U.S. dealt with economic issues in China. Main points of each think tanks are as follows.

∙ AEI

1. **China’s foreseeable economic policy for the next five years**: China is facing the potential of middle income trap, due to an old economic growth model. In order to break this trap, China needs a political courage to make fundamental reform, and the president already made decision to do so, which is quite ambitious. At the same time, the trend of current policy making of the government seems to be more inclined to stronger socialism.

∙ Brookings

1. **Adjusting China-India relations**: There is a growing possibility for India-China relationship go through a new development due to growing national power of two countries. These are some forecasts on how it will go. Firstly, China is unlikely to seek an early settlement of the ongoing border dispute with India but to stabilize the status quo, Chinese will keep the border issue alive as a lever in its relationship with India. Furthermore, in the short term, the cooperative-competitive pattern in both countries will likely to continue.
2. **How Xi Jinping sees the world and why**: The new ideas of the Xi era reflect massive changes in China’s place in the international system. Xi has a firm faith in the necessity of a strong Communist Party to govern China, an aversion to chaos and social instability, a commitment to China’s economic growth based on acceptance of the role of markets. China under Xi remains firmly embedded in the major institutions of the international system. In addition, Xi’s foreign policy has been the innovations and new directions. Here are some prospects. China is likely to continue to follow a zig-zag path in its attitude toward the international system. The most important indicator of China’s commitment to the international system will be its attitude toward use of force in contentious areas.

∙ RAND

1. **The Power to Coerce**: Mounting costs, risks, and public misgivings of waging war are raising the importance of U.S. power to coerce (P2C). The best P2C options are **financial sanctions, support for nonviolent political opposition to hostile regimes, and offensive cyber operations**. The state against which coercion **is most difficult and risky is China**, which also happens to pose the strongest challenge to U.S. military options in a vital region.

∙ CFR (Council for Foreign Relations)

1. **Criticizing current China’s economic policy**: The main point of this article is about the reality that China’s growth is slowing, and the wrong response might make the problem worse. These are the three arguments recommending China would better follow. **Firstly, accept the slowdown gracefully**. Do not deny or defying it. If China’s leaders follow Nixon by trying to boost growth with low interest rate and government-directed lending, China will add to its debt burden. **Secondly, the system of artificially low returns for savers (capping bank-deposit rates) is outdated**. China needs a financial system that generates fewer bad loans, make better use of saving, and frees consumers to become the engine of the nation’s economic growth. **Thirdly,** China now seems tempted to pursue a cautious version of Nixon’s strategy, i.e**. devaluing a currency**. However, if a country begins devaluation but stops short of allowing its currency to reach its natural level, investors will expect the currency’s value to fall further, and will therefore withdraw money from the country.

∙ CSIS (Center for Strategic & International Studies)

1. State and Market in Contemporary China
2. **AEI (American Enterprise Institute)**
3. **China’s foreseeable economic policy for the next five years**

It regarded the current Chinese economy as a porcelain economy.[[1]](#footnote-1) There are two things going on in the Chinese economy. Many people see these two as connected phenomena, but they are two separate problems.

1. **Continuing slowdown of growth and the middle income trap**[[2]](#footnote-2): The credibility of current Chinese government heavily rests on economic prosperity, i.e. maintaining 6.5% economic growth for the next five years. However, slow economic growth, some regards it as 4.0% or so, has been happening for several years, and the reason for this is that the Chinese government has been using the same old growth model, which is to use easy credit and public investment to boost economic growth. Economists have been saying that the country needs a transition to more of a consumer-driven economy, so the government is planning to do this big transition at least more than a year ago, but it seems it hasn’t happened yet. **The Chinese president has already set it as his target, and it is very ambitious, but transition to a new growth model can accompany the potential political changes and unrest.** The reason is that there’s a lot of vested interest in economy attached to the old model of economic growth. So it takes political courage to break the trap.
2. **A boom and bust in the stock market**: This exposed many problems about how the Chinese government is making economic policy. In particular, Weifeng Zhong called it as a ‘**China’s lurch back to socialism**,’ for example, in order to prevent the stock market index from going down, the government intervened and rolled out a lot of rescue measure. In doing so, the government is destroying economic freedoms by intervening in the economy whenever the government feels the need to.
3. **Brookings**

In this week, it dealt with China-India relations[[3]](#footnote-3). At the same time, there was a report on Xi Jinping, more specifically, on how he sees the world.

1. **Adjusting China-India relations: Duality**

India and China has developed their economics rapidly for the last thirty years, especially China’s rise is opening an opportunity for new type of China-India relations. The author saw that China has been assertive since 2008 and it will continue to be like that in the foreseeable future.

1. **China is unlikely to seek an early settlement of the ongoing border dispute with India but to stabilize the status quo**. : China is considering a lot of issues related with India, they are religious extremism and territory in Xinjiang, overland access to the Indian Ocean, keeping India in Check, a window on Western arms technology, the Chinese commitment and presence in Pakistan Occupied Kashimir[[4]](#footnote-4), at the same time, China remains dependent on the Indian Ocean and has suspicious about India-U.S. defense cooperation and strategic coordination. Therefore, Chinese will keep the border issue alive as a lever in its relationship with India.
2. **The cooperative-competitive pattern will likely to continue[[5]](#footnote-5)**: Above all, China and India have a lot to cooperate, firstly, China is now India’s largest trading partner in goods. Furthermore, they are working together on several global issues in multilateral forums[[6]](#footnote-6), both countries have an interest in improving on the existing security and economic order. There are also risks in India-China relations. One is the rise to power in both countries of conservative, authoritarian centralizers, the other is the mutual gap between perception and reality.
3. **How Xi Jinping sees the world and why[[7]](#footnote-7).**

∙ From Mao, Beijing regarded the international order as illegitimate, representing the triumph of the strong over the weak, of the imperialists and colonialists over their victims.

∙ During the years of Deng IXiaoping’s rule, China joined or started on the road toward joining all of the key organizations in the UN system that is had once denounced. As China shed the role of revolutionary power and declined to become a revisionist power, it nonetheless **continued to have an ambiguous attitude toward the international order**.

∙ The new ideas of the Xi era reflect **massive changes in China’s place in the international system**, its economic, political, and military strength, and China’s expectation that the international system would and should accommodate this transformed China.

∙ Xi emerged from the experiences of privilege and suffering with **a firm faith in the necessity of a strong Communist Party to govern China, an aversion to chaos and social instability, a commitment to China’s economic growth based on acceptance of the role of markets**, and demand for respect for China internationally.

∙ China under Xi remains **firmly embedded in the major institutions of the international system**, such as the United Nations, the World Trade Organization, the World Bank, etc.

∙ **Xi’s foreign policy has been not so much the continuity and elements of the past, but the innovations and new directions**. China under Xi worked outward from its neighborhood, has consolidated China’s position as the dominant actor in the Asian economy by establishing the Asia Infrastructure Investment Bank (AIIB), also in central Asia, Xi has announced a modern version of the ancient Silk Road, the so-called “One Belt One Road’ strategy designed largely to fund projects from China’s west through Central Asia to the Middle East and Europe.

∙ Xi is certainly a more forceful, assertive, and ambitious leader than his predecessor. He has behind him a China with greater capacity-economic and military- than any of his predecessors.

∙ **China is likely to continue to follow a zig-zag path in its attitude toward the international system**. It will further develop its relationship with the international system and interdependence with other countries, but at the same selectively adhere to international norms where they fit its interests and ignore or seek to change them where they do not. **The most important indicator of China’s commitment to the international system will be its attitude toward use of force**. So far, it has been circumspect in this regard. The principal areas of risk are over areas China considers its sovereign territory but which others dispute: Taiwan, islands in the South China Sea, and the Senkaku/Daoyu islands in the East China Sea.

1. **RAND**
2. **Psycholinguistic analysis on attitudes toward local and national government in Chinese social media[[8]](#footnote-8)**

∙ This analysis focused on social media content analysis on the July 2014 “Husi incident,” a food safety scandal involving expired meat in McDonalds and KFC. It can help provide insight into the attitude of Twitter and Sina Weibo users toward local government, national government, and Western companies. The issue of food safety engages important themes in Chinese domestic politics, such as the watchdog role of the press and the challenges in an authoritarian system.

∙ Key findings are as follows. Firstly, Chinese opinion is attuned to both local and national government responses. Secondly, twitter frustration regarding the incident may have been directed less toward the local government and more toward the national government and U.S. companies. Thirdly, Weibo users appear to have felt a greater sense of community and less depression or insecurity regarding the national government.

1. **The power to Coerce** – RAND’s policy report[[9]](#footnote-9)

This report is about how to counter adversaries without going to war. Mounting costs, risks, and public misgivings of waging war are raising the importance of U.S. power to coerce (P2C). The best P2C options are **financial sanctions, support for nonviolent political opposition to hostile regimes, and offensive cyber operations**. The state against which coercion **is most difficult and risky is China**, which also happens to pose the strongest challenge to U.S. military options in a vital region.

∙ Russia, Iran, and other states that are less powerful and prominent than China are more-susceptible targets for coercive power.

∙ Financial sanctions on China would be more complex, difficult to implement and maintain, and perilous for the world economy than are such sanctions on Russia or Iran.

∙ Support for prodemocracy opposition can be very threatening, and therefore high leverage. This method of coercion is most likely to work against Iran and least likely to work against China.

∙ Offensive cyber operations are a high-return, high-risk coercive option. The risks and costs of retaliation and escalation are considerable if the target country is a “cyber power,” as China and Russia are. Iran is more susceptible to cyber coercion.

1. **CFR (Council for Foreign Relations)**
2. **Criticizing current China’s economic policy[[10]](#footnote-10)**

The main point of this article is about the reality that China’s growth is slowing, and the wrong response might make the problem worse. In order to deliver his points, he used analogy of Richard Nixon’s administration’s faults. Here are the recommendations for the Chinese government.

1. **Accept the slowdown gracefully. Do not deny or defying it**. : It is the most important lesson. Richard Nixon bullied the Federal Reserve into conjuring up a stimulus, just as China’s ruling State Council recently directed the People’s Bank of China to cut interest rates. Nixon’s efforts to force growth above its natural level stoked **a double-digit inflation, wiping out savings, and back-to-back recessions at the start of the 1980s**. Likewise, **if China’s leaders follow Nixon by trying to boost growth with low interest rate and government-directed lending, China will add to its debt burden**. Already, the debts of the government and of the banks are expanding at about twice the rate of the economy, according to the China watcher Michael Pettis, debt is piling up much faster than the country’s ability to repay it.
2. **The system of artificially low returns for savers (capping bank-deposit rates) is outdated** : Nixon’s financial policy, i.e. doing nothing, resulted in savings-and-loan crisis, which would eventually cost U.S. taxpayers more than $100 billion. Likewise, China’s status quo is unsustainable. The artificially low returns to savers represent a vast hidden tax on Chinese families, crimping consumption and forcing China to rely unhealthily on investment spending to power growth. **China needs a financial system that generates fewer bad loans, make better use of saving, and frees consumers to become the engine of the nation’s economic growth**.
3. Criticizing China’s attempt to devalue a currency to boost economic growth: In Nixon’s era, the U.S. pegged its currency to gold, and as part of his attempt to boost growth, Nixon abandoned the gold link. Exchange-rate regimes work best when a currency is either truly fixed to a peg or allowed to float freely. The middle ground is treacherous. However, **China now seems tempted to pursue a cautious version of Nixon’s strategy, i.e. devaluing a currency**. Nevertheless, if a country begins devaluation but stops short of allowing its currency to reach its natural level, **investors will expect the currency’s value to fall further, and will therefore withdraw money from the country**.
4. **CSIS (Center for Strategic & International Studies)**
5. **State and Market in Contemporary China – Toward the 13th Five-Year Plan (Coming up)**
1. Refer to “Handle with care! A Q&A with Weifeng Zhong on China’s porcelain economy,”(https://www.aei.org/publication/handle-with-care-a-qa-with-weifeng-zhong-on-chinas-porcelain-economy/) in this article, the interviewer was James Pethokoukis, and interviewee was Weifeng Zhong. Therefore, we can say that these views are mainly those of Weifeng Zhong. For more information about Weifeng Zhong, he holds a degree from China’s Shantou Univ, Mecon and Mphil degrees in economics from the University of Hong Kong, and MSc and a PhD from Northwestern University. (https://www.aei.org/scholar/weifeng-zhong/) [↑](#footnote-ref-1)
2. The conditions of middle income trap are low growth, crimped worker productivity and stagnating household wealth, etc. [↑](#footnote-ref-2)
3. “What China’s rise means for India. (<http://www.brookings.edu/blogs/order-from-chaos/posts/2016/03/04-india-china-relations-menon?rssid=china&utm_source=feedblitz&utm_medium=FeedBlitzRss&utm_campaign=FeedBlitzRss&utm_content=What+China%E2%80%99s+rise+means+for+India)>,” by Shivshankar Menon. [↑](#footnote-ref-3)
4. It has made Pakistan even more crucial to China. India is facing a complex situation in foreign relations. In particular, Pakistan is playing a game to suck India into confrontation, thus establishing Pakistan’s utility to those who feel the need to balance India’s rise, including China, the U.S., Russia, etc. [↑](#footnote-ref-4)
5. Maritime security is a good example of that duality. Both countries have a common interest in keeping sea lanes of communication open, but each will oppose any attempt by the other to control the seas and straits. [↑](#footnote-ref-5)
6. Such as the World Trade Organization and climate change negotiations, etc. [↑](#footnote-ref-6)
7. For full version of this report, go to http://www.brookings.edu/~/media/research/files/papers/2016/02/xi-jinping-worldview-bader/xi\_jinping\_worldview\_bader.pdf. [↑](#footnote-ref-7)
8. For full text, go to <http://www.rand.org/pubs/research_reports/RR1308.html>. In my personal opinion, as RAND said in this report, studies on exploring more rigorous methods for selecting words are necessary. [↑](#footnote-ref-8)
9. For full text, go to <http://www.rand.org/pubs/research_reports/RR1000.html>. Policy recommendations are worth to take a look. [↑](#footnote-ref-9)
10. “What China could learn from Richard Nixon?” (<http://www.theatlantic.com/magazine/archive/2016/03/what-china-could-learn-from-richard-nixon/426864/>) by Sebastian Mallaby. He is the Paul A. Volcker Senior Fellow for International Economics at the Council on Foreign Relations and the author of a forthcoming biography of Alan Greenspan. [↑](#footnote-ref-10)