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Publications

Asia-Pacific Rebalance 2025: Capabilities, Presence, and Partnerships
CSIS, January 2016

This major independent review of US defense strategy reviews the full spectrum of American defense posture, capabilities and relationships in the Asia-Pacific. The report delivers four key recommendations: that the "rebalance" strategy (previously known as the "pivot") must be articulated with more clarity to Americans, US allies, and actors such as China; that the US should accelerate its programs to build partner capacity in the region; that it should expand its military presence in the region to keep up with a changing security environment; that the US reestablish an edge in innovating both capabilities and strategies. Each of these recommendations is supported by detailed proposals in the domains of diplomacy, force posture, alliance coordination, and military capabilities and strategy.

South China Sea Lawfare: Legal Perspectives and International Responses to the Philippines v. China Arbitration Case
South China Sea Think Tank and Taiwan Center for Security Studies, January 2016

Multiple authors discuss the legal perspectives, security policies and diplomatic strategies of China, Philippines, Indonesia, Malaysia, Australia, the United States and others in regard to the South China Sea and the pending decision from the Permanent Court of Arbitration in the Philippines' case against China.

China Investment Corporation's Forays into Europe and the United States: Explaining the Different Receptions
Friedrich Wu & Andreas Bakke Froystadvag

The authors take note of the different treatments the China Investment Corporation (CIC)—China's largest Sovereign Wealth Fund (SWF)—receives from the United States, the United Kingdom and France. CIC, like all sovereign wealth funds, must navigate both a regulatory and a political environment in order to invest in a given country, but the approval processes and the political environment varies from one state to another. The paper focuses on the vagueness of the regulatory process (what the authors call "flexibility"), as well as the political climate. In the United States, investments by SWFs must be approved by an executive branch body—the Committee on Foreign Investment in the US—in order to ensure the investment is not prejudicial to national security. The authors find that due to how broadly "national security" can be construed, the Committee exercises considerable discretion. This means that the approval process is susceptible to "politicization." The authors describe this regulatory environment as contrary to OECD guidelines and "discriminatory." By contrast, France, though sharing in the United States' circumspection about Chinese investment, has an inflexible and impartial regulatory process that is not prone to politicization. The authors contend that the CIC fares better in the UK than in the US because of warmer relations between Beijing and London, despite the UK's similarly "flexible" regulations.

Let China win. It's Good for America
Joshua Kurlantzick
Washington Post Op-Ed, January 15, 2016

Kurlantzick takes the Obama administration's futile opposition to the Asian Infrastructure Investment Bank (AIIB) as emblematic of what he considers to be a "muddled" and "mindless" US policy of opposing China at every turn. Kurlantzick notes that the US has very real conflicts of interest with China, including in the South China Sea. However, he also sees a pattern of American opposition to China in other regions and policy areas in which there is no real competition between the two. He notes that the AIIB is welcomed by many countries, and given that ADB and other banks cannot keep up with infrastructure demand, it won't exactly be a competitor. The US shouldn't worry about Chinese investment proliferating around the world either, given the fact that many nations targeted by Chinese investments are economically irrelevant to the US. Kurlantzick concludes by suggesting that the US pick its battles with China more judiciously.

Time is of the Essence in South China Sea Arbitration Case
Ernest Bower and Conor Cronin
CSIS Asia Maritime Transparency Initiative Blog, January 13, 2016

Bower and Cronin discuss how timing could be an important factor in the Permanent Court of Arbitration's decision in the Philippines v China case. The Philippines will hold presidential elections in May, and a decision shortly before or after that would present an incoming administration with difficult decisions about how to proceed with Philippine-China relations. Moreover, the Philippines' course of action could vary depending on the victor, given that the major candidates have expressed a diversity of views on how best to deal with China. The authors hope that a decision will come down from the PCA as soon as possible in order to allow current president, Aquino, time to formulate and institutionalize a policy in response.

Persuading China to Cooperate against North Korea
Doug Bandow
Cato Institute, January 15, 2016

Bandow describes the current US approach to North Korea as futile, as is the approach of criticizing China's inaction in this policy area. In truth, China is not as troubled by North Korea as the United States is, and, thus, the US has much work to do to build a policy that the Chinese can support. Bandow lists a series of policy initiatives aimed at addressing Beijing's concerns about North Korea that are also amenable to the US. This includes an attempt at engagement with the DPRK and a promise to withdraw US troops from the peninsula in the event of unification.

Commentary Series: Balancing Cooperation and Containment
The Cipher Brief, January 18, 2016

Rethinking U.S. Strategy Toward China
John McLaughlin

McLaughlin, former Deputy Director of the CIA, describes the United States' challenge with regard to China as getting the balance right between hedging against the possibility of an antagonistic relationship and preventing such precautions from creating a self-fulfilling prophecy. He notes that this may be especially difficult given the apparent Chinese perception that the United States is committed to containing its rise rather than simply preparing for the possibility of a conflictual relationship. He recommends that the US remain flexible in its policies so that it may speak out when it believes China is undermining global norms but also engage where interests align.

Protecting American Interests
Senator John McCain

McCain argues that US policy towards China should enhance cooperation while keeping competition in check. In his eyes, however, the relationship has become unbalanced due to President Obama's unwillingness to put sufficient pressure on Xi Jinping, and China's increasing tendency to "bully" its neighbors. McCain argues that Americans should resist the language of a "new model" of great power relations because, in his mind, it legitimizes Chinese aims without requiring China to conform to a "rules-based" international order, and it sends a counterproductive signal to US allies in the region. He urges US statesmen to be persistent in supporting human rights and the US-Taiwan relationship even if it complicates US-China relations.

Responding to Chinese Aggression
Representative Madeleine Bordallo

Bordallo discusses her concerns with China's development of A2AD capabilities and activities in the East and South China Seas. While the threat of the "Thucydides trap" is real, the US should also make sure that it doesn't "spend itself into oblivion" in an attempt to match Chinese military capabilities. Rather, the US can, and should, invest intelligently in technologies such as the new long range bomber and rail guns. Like Senator McCain, Representative Bordallo also spoke critically of Xi's "new model" concept, describing it as a way of legitimizing Chinese territorial claims.

Isolating China: Why the Latest U.S. Freedom of Navigation Operation May Have Already Succeeded
Julian Ku
Lawfare, February 1, 2016

Ku discusses the US Navy's latest freedom of navigation operation (FONOP) near Triton Island in the Paracel Islands this January. The operation could be considered a success given the response not from China, but the two other claimants to the Island, Vietnam and Taiwan. The policies of all three have in the past have differed from the United States' interpretation of the UNLCLOS provisions for "innocent passage." While the US believes that the right can be exercised without prior notification or permission, China, Vietnam and Taiwan require prior approval. The FONOP mission was explicitly directed at all three claimants, yet Taiwan and Vietnam signaled acceptance of the operation in what Ku believes is a possible sign of growing acceptance for the US's interpretation of UNCLOS.

Events

Assessing the Outcomes and Implications of Taiwan's January 2016 Elections
Remarks by DPP Secretary General Joseph Wu
CSIS (in collaboration with Brookings), January 18, 2016

Wu described the DPP's agenda following the election of Tsai Ing-wen to the presidency. He argued that DPP appeared to voters to be the most responsible political party in Taiwan, both on domestic and foreign policy. He noted that DPP's policy has been to maintain a moderate stance toward cross-strait relations, and China seems to have done the same for most of the election cycle. It appears to Wu that China has prepared itself for a DPP victory. Wu articulated the DPP's approach to cross-strait relations. This seeks to strike a careful balance between rejecting the specific terminology associated with the "1992 consensus" while also reassuring Beijing that the DPP will persist with a spirit of reconciliation.

Asia-Pacific Rebalance 2025: Capabilities, Presence and Partnerships
CSIS, January 20, 2016

This event featured presentations and a panel discussion regarding the findings and recommendations of CSIS's independent review of US Asia-Pacific defense strategy (discussed above). Report authors and other speakers included Mark Cancian, Michael Green, Kathleen Hicks, Andrew Shearer, Zack Cooper and John Schaus.

Commentary

Will China's Resilient Growth Model Adapt?

Sourabh Gupta

On January 19th, 2016, China's National Bureau of Statistics released its preliminary estimate of gross domestic product (GDP) for 2015, showing that the economy's growth rate had decelerated from 7.3 percent in 2014 to 6.9 percent in 2015. The numbers brought to the fore a latent tension that has simmered between the markets and the media's view of China's growth prospects, and Chinese officials' own reading of their macro-economy.

The markets and the media were quick to observe that China had suffered its slowest growth in a quarter century and, further, that the fourth quarter growth figure represented the lowest quarterly expansion since the aftermath of the global financial crisis. They pointed to the marked deceleration or outright decline within key segments of China's investment-driven growth model—real estate fixed asset investment; capital spending by businesses; exports—as confirmation that the model had run its course, with no sign of a successor model on the horizon. The International Monetary Fund's (IMF) marking down of China's projected GDP growth for 2016 (6.3 percent) and 2017 (6.0 percent), the continuing proliferation of overinvestment-driven indebtedness within the economy (the ratio of debt to GDP rose from 250 percent in 2013 to 290 percent in 2015) and the volatility in domestic capital and foreign currency markets, are all reflections of this trapped transition. Should the scale of capital outflows ratchet upwards abruptly and a run on the renminbi ensue, a full-blown crisis and hard economic landing cannot be ruled out.

On the other hand, for China's economic policy-planners, the decelerated rate of growth—which was consistent with the targeted GDP rate—was affirmation that the shift to a new growth model based on higher domestic consumption and expanded services was on-track. Rates of growth within key segments of the prevailing growth model were slow because authorities had deliberately engineered them to be so, such as the stark contraction in shadow bank lending due to stricter regulation and retrenchment in the real estate sector due to a measures such as the reduction of land supply in cities with excess housing inventory. The volatility in the markets, meanwhile, was a function of the growing regulatory pains associated with the implementation of a series of financial sector liberalizations (of interest rates, the exchange rate, capital flow measures, and deposit insurance) that was compounded by poor official signaling at a time of skittishness in international capital markets.

When combined with the still-powerful role of the state, fiscal and financial buffers provide authorities with ample policy tools to manage aggregate demand while coping with a disorderly correction or contingency. The central government's pragmatic approach, as part of its Debt Swap program, to partially relax the hard budget constraint imposed on local government financing vehicles so as to ensure their continued financing—and demand creation—in response to weak economic data in early-2015, is a case in point. Moreover, the principal risk for China lies not in a measured deceleration in the rate of growth, but in reverting to the old habits of an over-stimulated economy. A calculated slowdown that is accompanied by a cutback in over-capacity, reduction in the stockpile of unsold homes, the restructuring of debts, and the wider entry of domestic and foreign service-sector suppliers is, in fact, is precisely the tonic that is needed.

The difference in the markets and the media's view of China and that of Chinese officials can be chalked up, in part, to their varying time-horizons. Markets tend to obsess over short-term events, conflate inscrutability of intent on the part of regulators as evidence of their seat-of-the-pants decision-making, and remain trapped in a rear-view construction of China's growth challenges. Chinese officials, meanwhile, remain riveted on realizing a set of forward-looking and longer-horizon programmatic reforms. The reforms to succeed those of the mid-to-late 1990s—such as state-owned enterprises, the fiscal system, the dualistic urban-rural economic structure, and of banking and finance—are no less ambitious than the their predecessor, and are in part meant to remedy the negative outcomes associated with some of these earlier reforms—notably the tax sharing system reform of 1994. Meanwhile, the structural, demographic, and urbanization-aided transition to a more consumption-driven growth model progresses steadily.

In 2010, the services sector as a share of GDP was 44 percent. By 2015, its share had risen to 51 percent—a full ten percentage points more than the once-dominant manufacturing sector. Since the Global Financial Crisis, the demand for urban labor has consistently out-stripped supply and wages as a whole have grown faster than nominal GDP. This rise in wages on the back of rising demand for labor, which has pushed up the share of income accruing to labor, has translated into higher disposable income, and a slightly reduced household savings rate, that has in turn fed into rising private consumption expenditures. Consumer spending has consistently outpaced GDP in recent years, contributed more towards growth than gross fixed capital formation and, as the recent National Bureau of Statistics data release confirms, contributed as much as 66 percent to GDP growth in 2015 – the largest such share since 2001. Indeed, as the instances of previous savings-surpluses and private consumption-constrained economies (Japan, Germany, Korea, Taiwan) that thereafter transitioned out of large and persistent current account surpluses attest, the typical surplus reversal was accompanied by an increase in net employment and consumption as labor shifted from the relatively capital-intensive tradeable to the more labor-intensive non-tradeable - typically services - sector.

China's foremost structural economic challenge, then, is not that it is trapped within an existing growth model exhibiting diminishing marginal returns, even as it gropes for a successor model that is only faintly visible on the horizon. That successor consumption and services-driven model is already establishing itself as a new growth motor for the economy. Rather, the challenge is that this consumption-driven model is not establishing itself at a pace that is consistent with full internal rebalancing and efficient demand management or at a level of productivity that could avert a significant growth slowdown down the line. The challenge is not a trivial one.

The East Asian growth model has been singularly unsuited to making this investment-to-consumption-led transition and every high-growth, manufacturing-intensive economy that has attempted it, notably Japan and South Korea, has suffered a significant slowdown. Even as the service sector's contribution to growth and domestic employment reached as high as 70 percent in these economies, the low productivity growth in the services sector constrained aggregate wages, shrank labor's share of national income, stymied investment-consumption rebalancing and exacerbated inequality. The net outcome was the underperformance of the share of consumption within the economy. In turn, this compounded the problems related to aggregate demand management. The gap in demand, typically, was bridged via credit or asset price bubbles (a by-product of the financial liberalizations implemented) that coincided with the peaking of working age.

China risks finding itself at the mercy of similar structural dynamics. The impressive recent gains in the service sector's share of GDP and the robust growth in per capita income has not been matched with an equivalent rise in the share of private consumption within the economy. Due to a continuing *rise* in the urban household saving rate, private consumption's share of GDP has barely inched upwards from 36 percent of GDP in 2010 to approximately 40 percent in 2015. Until this trend, urban household savings rates have not reversed and urban disposable incomes, as a share of GDP, have significantly risen, China risks being ensnared in a sub-par growth equilibrium of its own making. China must actively liberalize services markets that would reap productivity-based wage gains for urban labor; shift the relative burden of taxation from labor income towards property, capital gains and inheritance taxes; and continue to fix the market for housing, and housing finance, to ensure affordability. Most notably, Beijing must be prepared to use its fiscal might to fund a more robust social safety net that would alleviate the preference for precautionary saving over discretionary consumption. If anything, the anticipated increase of the urban population by 300 million over the next three decades makes this agenda for action even more pressing.

China's economic planners have profound prospective challenges to deal with. Obsessing over hypothetical short-term landings, whether hard or soft hard, improperly frames the economic tests at hand and is best left to the markets and the media.

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