

U.S.-CHINA RELATIONS: THE YEARS AHEAD



Address by
**THE HONORABLE
MATTHEW NIMETZ**

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- preserving and strengthening national security;
- supporting countries committed to the values and the practice of political, religious, and cultural pluralism;
- improving U.S. relations with the developed and developing worlds;
- advancing human rights;
- encouraging realistic arms control agreements;
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LETTER FROM THE PRESIDENT

Dear Reader:

Dealing with the rise of China will remain one of the most challenging issues for American foreign policy in the years ahead. Maintaining a steady relationship between China and the United States will be difficult because the number of issues that could disturb the equilibrium is increasing.

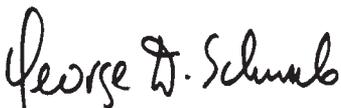
This is not because of a desire on either side to be antagonistic but because of different national interests as China grows in power and wealth in a world environment that is increasingly fragmented and difficult to manage successfully.

There are three spheres in which China-U.S. interests differ markedly: first, in political philosophy; second, in perceived threats to the sense of strategic security requirements; and third, in competing economic interests.

While recognizing the many areas where our policies, values and interests coincide, serious professionals in both countries should honestly take account of the important and difficult issues that divide us and understand that they will not go away and might even become more divisive in a low-growth global economic environment. The importance of maintaining a positive relationship in this situation becomes more important, requiring constant work on both sides.

Ambassador Matthew Nimetz, a former senior U.S. diplomat with investment experience in Asia, examines the nature of likely future challenges and offers important suggestions for maintaining a positive relationship between the two great powers.

George Schwab

A handwritten signature in black ink that reads "George W. Schwab". The signature is written in a cursive style with a large, prominent initial "G".

U.S.- CHINA RELATIONS: THE YEARS AHEAD*

*By The Honorable Matthew Nimetz***

November 12, 2012

BOTH THE UNITED STATES AND CHINA are going through a transition in leadership at this time. In the United States, through a long, complicated, open and costly process, we have wound up pretty much where we were, with most of the same faces in the same positions. In China, also through a long, complicated, but not so open and probably not so costly (who knows?) process, China has also wound up pretty much where it was, although some of the faces are different.

In my view, not much has changed or will change in either country in the way we look at each other or at the world. The reason for this is because the fundamentals of the relationship between China and the United States, the realities of a global economy and the way both countries define security will not change materially. So, we are likely to be in for a very long period of stressful U.S.-China relations, which hopefully will be managed on both sides by professionals dedicated to maintaining a guarded equilibrium. If this can be accomplished, it will stabilize the relationship and provide the world with a foundation for generally peaceful evolution of the international situation. But this type of positive long-term evolution in the relationship should not be taken for granted, and there are grave risks given the issues that divide the two largest world economies, which are also becoming the two strongest military powers.

Maintaining a steady relationship between China and the United States will be difficult because the number of issues that could disturb the equilibrium is not decreasing; in fact, many of these are more likely

*This presentation was given at a meeting between the National Committee on American Foreign Policy (NCAFP) and China Institute of Contemporary International Relations (CICIR) on November 12, 2012.

**Matthew Nimetz has served in a number of official government positions, including special envoy for President Bill Clinton and Counselor of the State Department and Under Secretary of State for President Jimmy Carter. Earlier, he was staff assistant to President Lyndon Johnson and law clerk to Supreme Court Justice John M. Harlan. He has also served in various appointed positions in New York State and New York City and at the United Nations. In the private sector, Mr. Nimetz practiced law as a partner of two major New York City law firms and has served as a managing director and chief operating officer of a leading global private equity firm. He is currently a trustee of the National Committee on American Foreign Policy, the Central European University in Budapest and the American University of Central Asia in Bishkek. He chairs the Advisory Board of the SUNY Global Center and serves on the board of several other organizations and corporations. He is a graduate of Williams College, Oxford University and Harvard Law School.

to intensify as time goes on. Therefore, I do not believe in the theory of convergence between the two great nations. Rather, I see competitiveness and suspicion likely to grow. Eventually, the two powers may learn to live with each other in a watchful way and to manage these sensitive areas of difference, but this will take statesmanship and forbearance on both sides. The reason I believe the atmosphere will get tougher rather than easier is because the areas of friction are in many cases becoming greater. This is not because of a desire on either side to be antagonistic but because of different national interests as China grows in power and wealth in a world environment that is increasingly fragmented and difficult to manage successfully.

There are three spheres in which China-U.S. interests differ markedly: first, in political philosophy; second, in perceived threats to the sense of strategic security requirements; and third, in competing economic interests. It would take too long to go into each area in detail, but I will outline a few concepts that I think we all should focus on.

Political Philosophy and Human Rights

It was convenient for many years to articulate a theory that China was evolving gradually from a harsh Maoist one-party state to a political and social system that was more respectful of individual rights and fair administration of law. In some respects, this occurred in a number of respects, and maybe the jury is still out, as we say in America. But more and more it appears, sadly, that those who lead China have set a firm red line as to permissible individual behavior, as well as political, cultural and social activities, which red line puts China so far from Western standards that they shock the conscience of most Americans and others who share a Western civil/human rights political culture. Profound difference in political and social philosophy and internal treatment of one's citizens, some say, should be ignored between state actors, but in fact it cannot be in the real world. We can see that harsh steps taken within China lead to constant friction in sensitive areas, whether the Nobel Prize process, arrests of renowned artists and writers, travel restrictions on large numbers of ordinary citizens who are viewed as potential troublemakers, restrictions on publishing, internet use, political organizing and religious observance, arbitrary unauthorized detentions and legal processes that are clearly politically motivated and not in accordance with Chinese law, let alone accepted international norms. The rule of law and its fair administration,

which seemed to be making progress a decade ago, have languished and are very clearly a source of concern both on an individual basis as a matter of human rights and on a business level as a matter of growing economic interdependence.

Along with political liberalization, there is the issue of minority rights—what most Westerners consider harsh and uncompromising treatment by the Chinese Government of certain ethnic groups. The United States understands the high priority given by Beijing to the issue of national cohesion and sovereignty, but its approach to minority cultural, religious and political rights seems draconian and vastly beyond what is needed to deal with any perceived threat to national sovereignty. Of course, we can hope that Beijing will modify these governmental policies over time, but we should also fear that with modern techniques of surveillance, its power to control the situation will grow.

To sum up, issues between the Western democracies and the Chinese governmental system make it difficult for either side to collaborate closely in many spheres of activity. And, of course, the harsh internal system preferred by China makes it extremely difficult to envision a peaceful, negotiated solution with respect to reunification with Taiwan, given the mature democratic and legal system enjoyed by the people there that contrasts so markedly with that of China.

Diverging Strategic Outlooks

We must recognize that China is now a great power with global interests. It has been convenient for many experts to articulate a view that China has historically been interested only in its own neighborhood, has never had global aspirations and has never projected power outside its immediate zone. And for many years, it was relatively easy for China to maintain good relations with almost all countries, because it espoused non-interference and good will. But this state of affairs existed mainly because China was for two centuries relatively weak and inwardly focused. Consequently, it had few important outside interests to pursue.

This situation is no longer the case. Now, China has major economic and strategic interests globally, which means it is required to make choices, exert power and, increasingly, run into opposition to its policies by others, including the United States. This is not to say there are not many common interests between Washington and

Beijing and that in the long run we will not work out a *modus vivendi*. Common interests include non-proliferation, climate change, some interests with respect to North Korea, issues of terrorism and the desire for stability in the Middle East. But there are many other areas where the differences between the two powers predominate and are growing. And these are increasingly important. It will take time and mutual forbearance to work these out and to minimize tensions when they arise.

Certainly, China's immediate regional interests are paramount to her. We see them now increasingly competing with U.S. security interests in East Asia and the broader Pacific region. In recent years, China has become more assertive in expressing its interests in the region in ways that appear adversely to affect such friends and allies of the United States as Japan, the Republic of Korea, several ASEAN countries and India. The United States has significant differences with China with respect to the DPRK and, more importantly, the long-term future of the Korean peninsula. We clearly have different approaches and policies with respect to navigation in regional seas and to issues of sovereignty and economic rights in various maritime areas adjoining China. Even if the United States is not itself interested in confronting China, our defense alliances and ties with other countries might force us into considering such action when incidents occur or when local situations escalate. We all remember Thucydides' lesson about the causes of the Peloponnesian War, that it is the localized interests of small allies that cause larger powers to get themselves into conflicts they never desired on their own account. And so far in this discussion we have not even mentioned Taiwan itself, the touchiest area of possible confrontation between the United States and China, where arms sales, defense commitments and the broader long-term relationship between the United States and Taiwan remain at best an irritants to the relationship and at worst a high-risk area of possible military confrontation. The fact is that the Taiwan issue is nowhere near solution, and China-U.S. relations will never be fully benign until it is solved.

With the planned 2014 withdrawal of U.S. military forces from Afghanistan and with China playing a historic strategic role in Central Asia as well—after all, it has a border with Afghanistan, Pakistan, India, Tajikistan, the Kirghiz Republic and Kazakhstan—we can expect China's role in this region to grow as its economic penetration and appetite for resources in that area increases. Also important in

Central/South Asia are China's legitimate apprehensions about the activities of outside Tibetan, Islamic and Uigher groups. These factors, together with China's great-power aspirations and historic rivalry with India, provide good reason for China to play the Great Game in Central/South Asia in the next decade once the United States withdraws most of its troops from Central Asia; it is likely that Beijing sees Russia and India as just as vulnerable as the other powers that have competed for domination there.

Even beyond contiguous areas, China's tremendous economic machine and its trading interests, which will only grow, may lead it to concern itself with selected security matters in such distant places as the South Pacific, the Indian Ocean, Africa, the Middle East and Latin America, where competition with the United States could lead to mutual suspicion and new areas of competition.

The growth and assertiveness of the Chinese military, particularly its navy and missile technology, will make these points of potential competition more dangerous. Add to this our rivalry in space and in cyber technology, including so-called cyber warfare, and we can see how many profound areas of security confrontation are possible during the next five or 10 years.

The major point I am making is that the view of China as essentially a limited regional power without broader security aspirations may not stand up in the coming decades. With the United States withdrawing from Afghanistan and reducing its interest in Iraq, it will be only a few years before the American military establishment focuses more heavily on perceived, perhaps exaggerated, Chinese threats. Then, the so-called pivot and a new commitment to "containment" could increasingly define United States strategic policy toward China.

The Economic Relationship

Many opportunities exist for positive developments between the world's two largest economies. Increasingly, the two great nations need to work together to fulfill their own interests. Within the private American sector there is great admiration and respect for China's accomplishments, and American and other Western business people genuinely enjoy working with Chinese collaborators. We are both entrepreneurial people, and in my personal experience working with and investing in China-based companies over many years,

American business people work more effectively with Chinese than with many other nationals.

But in the economic sphere, too, there are storm signals that need to be dealt with. The last 20 years, during which U.S.-China business relationships flowered, were high points of growth, globalism and trade expansion. China needed Western technology, capital and markets. Things are different now. China does not need our technology as vitally as it did previously, and it has more than enough capital for its need; moreover, China now has a large and growing internal market and other developing markets and will increasingly rely less heavily on the United States and Europe to absorb its products. With the continued dominance of state-owned and dominated enterprises and banks in the Chinese economy (notwithstanding reforms to curtail their role), the role of foreign investment and the establishment of true competition within the Chinese internal market actually appears to be declining rather than growing, as we all once believed it would.

All this takes place in a world economic environment that is very different from that of 20+ years ago. The volume of world trade appears stagnant or even in decline; at any rate, it is certainly not in a rapid growth cycle. This is due primarily to the financial crisis in Europe and low growth in the United States, China's two largest markets. This risks a reduction in China's exports, certain in its rate of growth. We do not know what is going to happen in this respect, but I personally believe the era of sustained high economic growth in the global environment is over for a while, and we have to content ourselves with a somewhat more sober world economy. In this context, the political forces pressing for protectionism will become stronger everywhere.

Chinese leaders understand this and are attempting a transition from an export-led economy to one more domestically focused, with emphasis on services and retail sales. But this is not an easy process. It disturbs many entrenched interests; the prevalence of corruption and vested interests is a major challenge to reform. Redirecting the economy requires more than broad policy directives but on the ground a change in product mix, a change in geographic focus and a need to redirect economic development from coastal regions to the center, north and western regions of China. It also involves lowering expectations of growth, which has already declined to 7.5% and may

go lower. All this will be difficult for China, and it has political and social consequences that the new leadership will have to tackle.

Of major importance also is the rapidly changing demographic situation on the mainland, with a relatively rapid shift in the population from younger workers to older pensioners. This demographic change plus a decline in movement of people from the villages to the cities will reduce the number of employable people, raising compensation costs and, at the same time, increasing social costs of retirement. Can China's new leadership undertake the reforms required to manage these transitions? This will be a key test.

In order to maintain growth and continue to build its scientific and technological base, China is using all its power and ingenuity, including its own form of protectionism, to build a modern economic structure and to protect key industries. The Beijing government increasingly uses its vast financial reserves to acquire businesses and commodity assets worldwide. It continues to bar outsiders from investing in key and some not-so-key sectors. It maintains an attractive exchange rate to keep its export advantages. It makes all-out efforts, including use of questionable techniques, to gain advanced Western technology. It is making a vast investment in education. On the whole, policies designed to maintain high growth are admirable, but more questionable methods need to be calibrated or totally abandoned to conform to WTO standards and accepted global practices. China is now a mature economy; it can no longer hide behind the mantra of a poor, developing country needing exceptions and forbearance from accepted standards of economic behavior. In a low-growth world economy, China will find fewer friends abroad willing to accept rapid Chinese growth at the expense of others. So, we should not be surprised to experience increased trade tension, protectionist backlashes, rivalry over commodities and the like in the coming years.

As to the United States, while we have many problems to solve, our country is, in my view, likely to experience some very positive developments in the coming years that will make us more competitive. Because of new oil and gas technologies relating mostly to extraction of oil and gas from shale, plus real investment in fuel savings and environmental protection (not noticed as much as it should be), the United States is becoming more self-reliant in energy supplies, with the prospect of relatively inexpensive energy in our

future. At the same time, given its needs and less advanced extraction capability plus its environmental growing energy problems, China is likely to have more difficulties and pay higher costs for energy in the next decade. In addition, perhaps the most important legislative change triggered by our recent election—liberalization of our immigration laws—could, if successful, bring a new wave of creative and capable workers to fuel the U.S. economy. At the same time, as noted earlier, China is likely to experience a relative reduction in its workforce and even a potential loss of talent, as enterprising young people are attracted to the West.

I also believe that, notwithstanding all the difficulties of the U.S. political system, our leaders will succeed in resolving our tax and fiscal issues during the next year or so. If they do so, it is likely to lead to a new period of American optimism and a spurt of economic growth.

If all goes well, as I am suggesting it will, the United States can look forward to a positive economic trajectory. By contrast, China's labor, environmental, safety and other costs are rapidly increasing, putting it in the unique position of possibly becoming uncompetitive both against low-cost producers in Indonesia, India, Bangladesh and advancing African countries and to higher-cost producers in the United States, Japan and even parts of Europe, where labor costs are being reduced rapidly and new, innovative manufacturing technologies are being introduced and developed. In sum, there's a real possibility that China's rapid economic growth may lag and that the Chinese economic machine may lose its competitive edge.

All this being said, China has done many things extremely well during the past couple of decades and hopefully, it will have a strong and prosperous future. Given the extraordinary economic base built up and its investment in infrastructure and education, there is no stopping China's continued growth. Still, where it will flatten out on a per-capita basis is not so easy to discern. If China wants to stay competitive and maintain the global trading and financial system on which its success depends, it will have to introduce substantial internal reforms, to play by accepted competitive rules, to give Western business a level playing field for investment and sales of goods and to integrate itself more completely into the open world system. This will be a challenge for China's new leadership.

What I call playing by the rules of the game includes maintaining the

open economic system separate from political difficulties with particular trading partners. This applies both to the United States and to China. For the United States, Chinese investment in our country is important, and we should pay less attention to the politics of the situation and permit such investment in our businesses and commodities. Of course, we need to continue to regulate where we have legitimate security concerns about particular investment applications. For China, recent restrictions on trade for purely non-economic reasons have troubled its relations with Japan, the Philippines and others. We understand the impact of public opinion in volatile national confrontations, but the Chinese, and sometimes the Americans, need to understand that international businesses, when they see reprisals against particular companies, such as those against Toyota and several other Japanese companies during the past few months in China, are troubled and must factor this type of political risk into future decisions about investment and business activities. Increasingly, major international companies are seeking to avoid becoming totally dependent on supplies from China; many of them are rethinking their supply chain to emphasize redundancy and safety and decreased political risk.

Summary

Profound differences exist between China and the United States based on different political systems, long-term national aspirations and security concerns, and very real economic interests. While recognizing the many areas where our policies, values and interests coincide, serious professionals in both countries should honestly take account of the important and difficult issues that divide us and understand that they will not go away and might even become more divisive in a low-growth global economic environment. The importance of maintaining a positive relationship in this situation becomes more important, requiring constant work on both sides. I believe a guarded, but mature and developing, relationship is possible if leaders in both countries take these risks seriously and address them constructively.





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