CSIS | CENTER FOR STRATEGIC & INTERNATIONAL STUDIES | Freeman Chair in China Studies

September 2011

FREEMAN REPORT

MORE IN THIS ISSUE

Publication

"*Should the United States Abandon Taiwan?*" by **Bonnie S. Glaser**

Event

September 30 *Challenges in Implementing China's Healthcare Reform Policies and Opportunities for U.S.-China Collaboration*

Freeman Facts

China's Outbound Foreign Direct Investment (see p. 5)

QUOTE OF THE MONTH

"China has made possible systematic stealing of intellectual property of American companies and has not been very aggressive to put in place the basic protections for property rights that every serious economy needs over time. We are seeing China continue to be very, very aggressive in a strategy they started several decades ago, which goes like this: you want to sell to our country, we want you to come produce here ... if you want to come produce here, you need to transfer your technology to us,"
~ U.S. Treasury Secretary, **Timothy Geithner**, speaking with unusual candor at a forum in Washington on Thursday, September 22. His comments reflected recent complaints sounded by U.S. politicians regarding Chinese intellectual property violations and fixed exchange rate policies, which they claimed hurt the United States economy and employment rates.

Source: *Reuters*, August 9, 2011.

The *Freeman Report* provides an open forum for individual opinions and commentaries on China. All opinions expressed in the feature essay of the report are those of the author.

Feature Article

CHINA'S HO-HUM WTO DECENNIAL

By Charles W. Freeman III

Over the past several months, I've had a number of conversations about China with Washington trade policy types that reflect a level of frustration greater than even the usual angst. Rather than concern over any specific bilateral trade issue, however, the frustration is best summed up by a question privately posed by one administration official: "How do we get China to pay attention to us?"

Tension over trade issues has of course long been a feature of the bilateral relationship. Issues like intellectual property rights protection, China's currency valuation, the politically explosive (if economically less-meaningful) bilateral trade deficit statistics and other matters have captured American popular attention and padded the frequent flyer mile accounts of American negotiators for years. Managing these issues and preserving a domestic consensus in support of open markets to China has been hard but not unrewarding work: despite all the gnashing of teeth and occasional hysteria, by any reasonable accounting the U.S.-China economic relationship is enormously successful and productive for both countries. China is a rare bright spot for U.S. multinationals these days, and many companies are doubling-down on their China businesses. Nevertheless, trade issues between the two countries are proliferating, and it is getting increasingly difficult to achieve meaningful progress on these issues, in part because Chinese officials don't seem to be taking American counterparts very seriously these days.

This isn't how it was supposed to be. December 11, 2011 will mark the 10th anniversary of China's entry into the World Trade Organization (WTO). WTO accession was heralded with great fanfare in China ten years ago, a sign that the country had joined the big leagues of international trade. WTO accession, at least by the numbers, has been a huge success for China. Over the past decade, since WTO accession, China's total trade volume has grown nearly six-fold, with China now accounting for nearly one-fifth of global trade in goods. China has used the WTO dispute resolution process with skill and pragmatism. Nevertheless, it is hard to find many Chinese planning a celebration of the WTO accession decennial. Indeed, many Chinese believe the country lost more by joining the WTO than it gained.

(continued on p. 2)

The WTO is about fair treatment in commercial dealings. If a country belongs to the WTO, it commits to treating foreign participants in its economy with an even hand. At its heart, WTO membership is about two principles: market access (that a country's default position should be to keep its market open) and national treatment (that a country should accord foreign players in its market the same treatment it accords its own). WTO membership is a web spun of reciprocal commitments to openness as a matter of national self-interest. WTO members recognize the benefit of adherence to the two core principles outweighs the parochial benefits to domestic firms that may be lost.

The realities of constituent politics in every political system inevitably claw away at international commitments to market access and national treatment. Domestic actors in every system can and will attempt to access (and sometimes manipulate) political processes to preserve or secure benefits in ways that run contrary to the essential spirit of WTO. Ironically and remarkably, China's leadership used the accession process as a political lever to overcome this kind of resistance to greater openness by vested interests in China. WTO accession was a matter of using foreign pressure to achieve national development goals, a matter of national political pride and priority. Hidebound economic interests were shunted aside as China implemented dramatic economic reforms with the goal of WTO accession and an embrace of market access and national treatment principles.

One of the watershed reforms in the run-up to WTO accession was the passage of the 1999 Contract Law, which was critical to removing the Chinese state as a primary actor in commercial dealings between two willing (non-government) parties. Allowing individuals and firms (domestic and foreign) to separately and independently establish transactions without following a state-directed plan was fundamental to the establishment of China's market-oriented economy and was critical to the proposition that the Chinese political process would not act to intervene in market access and national treatment.

The drafters of the Contract Law studied western concepts of contract intensively in promulgating the law. One of the most hotly-debated concepts during the drafting process was the notion of "freedom of contract," meaning the right of an individual to make a legally binding mutual agreement with another without governmental interference as to what type of obligations he or she can take upon himself or herself. While many of those involved in the drafting recognized the importance of this concept to the creation of an effective market economy, and earlier drafts of the law included specific references to freedom of contract, the final version eliminated them, reflecting the fundamental discomfort of those in the government concerned with ceding the ability to circumscribe commercial relations more carefully. Thus, Article 7 of the Contract Law states, ambiguously and with much room for government intervention: "In concluding or performing a contract, the parties shall abide by the relevant laws and administrative regulations, as well as observe social ethics, and may not disrupt social and economic order or harm the public interests."

That, at the height of the market reform era, China was unwilling to enshrine freedom of contract in its legal regime foreshadowed the continued assertive role of the state in directing commercial relations. In the following decade, and particularly since the most

(continued on p. 3)

IN THE NEWS

WASHINGTON - Yi Gang, Director of the State Administration of Foreign Exchange and Deputy Governor of the People's Bank of China, said on September 23 that China would be willing to extend limited support to European economies, but that ultimately Europe would be responsible for solving its sovereign debt crisis. Spain, Portugal, Greece, and Italy have sought investment from China, leading to speculation that China may buy Eurobonds as a way to help stabilize European economies. Yi's comments reiterated China's commitment to investing in Euro. Previously, Chinese Premier Wen Jiabao has responded to calls for China to take a more active role in Europe's current debt crisis by stating that countries should reduce their deficits and open up markets rather than rely on China, but other Chinese officials including Zhang Xiaoqiang, vice chairman of the National Development and Reform Commission, China's top economic planning agency, said China is willing to buy European debt "within its capacity."

BEIJING - The Chinese government expressed strong protest on September 21st over the recent $5.8 billion United States arms sale package to Taiwan. The final arms sale package was downgraded to comprise upgrades of existing Taiwanese fighters, rather than the 60 new F-16s originally planned. Despite this change, Chinese government officials have stated that they consider the latest arms package a breach of international trust by the United States. The last major arms sale to Taiwan in 2010 resulted in a suspension of military exchanges between China and the United States that lasted nearly one year. While there have been calls for China to take retaliatory measures against the United States in response to the most recent arms deal, many commentators expect that the bilateral relationship is likely to remain largely unchanged.

recent economic crisis, market principles have fallen increasingly out of favor. Indeed, it would be hard to find a consensus in Beijing these days that supports the principles that market access should be available for all comers irrespective of nationality, or that foreign firms merit the same treatment as national firms. Commercial dealings, far from being guided by the right to "freedom of contract," are increasingly subject to intrusion and circumscription, and local firms are increasingly manipulating the political process to dictate the terms of foreign participation in the marketplace. This still is having a marginal impact on the success of most foreign firms to date, but it is worrisome to those (including Chinese) who are trying to preserve the hard-won benefits of market access and national treatment achieved ten years ago.

One problem for trade policy types in Washington trying to determine a pathway forward with their Chinese counterparts is that China doesn't have to keep negotiating for WTO accession. That process was completed ten years ago, with Chinese officials and leaders who genuinely believed in the importance of WTO membership (and thus gave other WTO members immense negotiating leverage during the run-up to accession). Now that there is no clear agreement in favor of market reform among Chinese policymakers, it's hard to see how beating the drum for national treatment and market access will have much impact on Chinese policymaking.

The WTO in some respects is an audacious creation: the cession by sovereign governments of some of their rights to restrict and control their own economy. By breaking down trade barriers, the WTO and the consensus among governments it represents stands for the proposition that a borderless commercial world is much bigger than the sum of its constituent parts. That consensus has delivered remarkable benefits and wealth to Americans and Chinese. But the consensus is fragile, and Americans and Chinese, among many others, seem to have forgotten what the alternatives look like.

For China, a more recent entrant into that consensus, this should be troubling: China is very dependent for its economic health and well-being on an effective rules-based system governing global trade. For the United States, that we are not more active supporting the WTO and the architecture it represents suggests we've lost our way a bit. That the United States has wavered in its leadership of a more robust WTO liberalization process; and has had trouble articulating much of a trade policy vision (other than one that is strikingly provincial in its approach) may have more to do with China's decreasing willingness to come to the table on substantive trade matters than anything else. On one level, the question "how can we get China to pay attention to us?" might be best answered with: "why should it?"

Charles W. Freeman III is Chairholder of the Freeman Chair in China Studies at the Center for Strategic and International Studies.

PUBLICATIONS

• "Should the United States Abandon Taiwan?" *The Washington Quarterly*, vol.34, no.4, Autumn 2011. By **Nancy Bernkopf Tucker**, Professor of History, Georgetown University and **Bonnie S. Glaser,** Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS

Prominent voices in America have begun to espouse the need to distance ties with Taiwan. The relationship, they argue, is a dangerous one, and is a greater liability than it is a benefit to U.S. foreign policy. As China gains global economic and military influence, Taiwan serves as an obstacle to the more important U.S.-China relations. Taiwan would be the most likely cause of a war between the United States and China. Taiwan also causes suspicion and mistrust between the United States and China, leading Beijing to believe the United States is containing China by keeping it divided from Taiwan. However, more important questions are whether sacrificing Taiwan could possibly improve these relations, whether the current diplomatic situation between the United States and China is conducive to improvement, and how a change would affect other U.S. interests. The authors argue that the United States should neither abandon nor reduce its commitments to Taiwan, but strengthen them. [Click here to view the full article]

• "US-China Relations: Friction and Cooperation Co-exist Uneasily" *Comparative Connections,* vol.13 no.2, CSIS, September 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS and **Brittany Billingsley**, Research Associate and Program Coordinator, Freeman Chair in China Studies, CSIS

In pursuit of agreements reached between Presidents Hu and Obama in January, the US and China worked to strengthen their relationship, while managing friction on a number of issues. Renewed tensions in the South China Sea put maritime security at the top of the agenda in many bilateral and multilateral interactions, including the inaugural US-China Consultations on Asia-Pacific Affairs, at the ARF in Bali, and in a meeting between Secretary Clinton and State Councilor Dai Bingguo in Shenzhen. In early May, the third annual Strategic and Economic Dialogue (S&ED) convened in Washington. Despite protests from China, President Obama met the Dalai Lama. In May and July, Chief of the General Staff Gen. Chen Bingde and Chairman of the Joint Chiefs of Staff Adm. Mike Mullen exchanged visits. In August, Joe Biden made his first visit to China as vice president. [Click here to view the full article]

(continued on p. 4)

Publications from the Freeman Chair 2011

***Please visit our Web site to access archived publications dating back to 2002.**

2011

September

•"Should the United States Abandon Taiwan?" *The Washington Quarterly*, vol.34, no.4, Autumn 2011. By **Nancy Bernkopf Tucker**, Professor of History, Georgetown University and **Bonnie S. Glaser,** Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS

August

•"US-China Relations: Friction and Cooperation Co-exist Uneasily" *Comparative Connections,* vol.13 no.2, CSIS, September 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS and **Brittany Billingsley**, Research Associate and Program Coordinator, Freeman Chair in China Studies, CSIS

•"Bali Accord on South China Sea is Overrated" *CogitASIA Blog*, CSIS, August 29, 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS

•"Is China's Aircraft Carrier a Threat to U.S. Interests?" *Critical Questions*, CSIS, August 11, 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS and **Brittany Billingsley**, Research Associate and Program Coordinator, Freeman Chair in China Studies, CSIS

July

•"China's Stake in the U.S. Debt Crisis," *Critical Questions*, July 28, 2011. By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, and **Jeffrey D. Bean**, Research Assistant, Freeman Chair in China Studies, CSIS

•"*China's New Leftists and the China Model Debate after the Financial Crisis*," CSIS, July 28, 2011. By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, and **Wen Jin Yuan**, Researcher, Freeman Chair in China Studies, CSIS

•""General Chen Bingde's Unsolicited Counsel," *CogitASIA Blog*, July 17, 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS

• "*U.S.-China-Taiwan Relations in the Run-up to 2012 Elections in Taiwan and the U.S. and Leadership Transition in China*," presented at a conference at the Carnegie Endowment of International Peace, July 7, 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS

June

• "*Tensions Flare in the South China Sea*" (a Draft from the South China Sea Papers), June 30, 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS

• "A Shifting Balance: Chinese Assessments of U.S. Power," *Capacity and Resolve: Foreign Assessments of U.S. Power*, CSIS, June 17, 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS

• "*China's Exchange Rate Politics: Decoding the Cleavage between the Chinese Ministry of Commerce and the People's Bank of China*," CSIS, June 16, 2011. By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, and **Wen Jin Yuan**, Researcher, Freeman Chair in China Studies, CSIS

• "A Conversation on Emerging Power Geometry," *Global Forecast 2011: International Security in a time of Uncertainty*, CSIS, June 15 2011. By **Charles W. Freeman III**, Chairholder, Freeman Chair in China Studies, **Karl F. Inderfurth**, Senior Advisor and Chairholder, Wadhwani Chair in U.S.-India Policy Studies, **Stephen Johnson**, Director, Americas Program, and **Stephen Flanagan**, Senior Vice President and Director, Henry A. Kissinger Chair, CSIS

PUBLICATIONS

• "Bali Accord on South China Sea is Overrated" *CogitASIA Blog*, CSIS, August 29, 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS

After nine years of negotiation, the recent agreement between China and ASEAN on a set of guidelines to implement the 2002 Declaration on the Conduct of Parties in the South China Sea (DOC) provides welcome consensus to the two sides' contentious relations, but it will likely bring limited changes to Beijing's strategy with territorial disputes. Until the two sides can identify behaviors that are unacceptable, consequences for violations, and progress toward implementing the basic confidence-building measures that were outlined in the DOC, there is little reason to think that there will be progress in the joint development of oil and gas between the two sides. [Click here to view the full article]

• "Is China's Aircraft Carrier a Threat to U.S. Interests?" *Critical Questions*, CSIS, August 11, 2011. By **Bonnie S. Glaser**, Senior Fellow, Freeman Chair in China Studies and Senior Associate, Pacific Forum, CSIS and **Brittany Billingsley**, Research Associate and Program Coordinator, Freeman Chair in China Studies, CSIS

On August 10, 2011, China's first aircraft carrier set sail from Dalian Port on its maiden voyage. The carrier, formerly called the Varyag, is a Soviet-era platform that China purchased from Ukraine. The acquisition of an aircraft carrier is driven in part by China's desire for international prestige. At the same time, however, the procurement of the carrier is a consequence of an improved continental threat environment that has imposed constraints on China's ability to develop sea power. China's intention is more likely to develop a limited power-projection capability that enhances China's ability to defend its regional interests. The ex-Varyag poses little threat to the United States and its allies in the region, as an obsolete aircraft carrier has limited military use. However, the acquisition of the aircraft carrier will likely make its neighbors more anxious about its military ambitions and reinforce their efforts to shore up their own capabilities. [Click here to view the full article]

CONFERENCE AND EVENT

• **October 18** *"Should the United States Abandon Taiwan? "*

This event, held in conjunction with the Washington Quarterly and the Freeman Chair, Bonnie Glaser and Nancy Tucker will present their recent article on Taiwan. Michael Swaine and Charles Glaser will serve as discussants. Alex Lennon, Editor in Chief, The Washington Quarterly and Senior Fellow, CSIS International Security Program, will moderate. 12-2pm at CSIS.

FREEMAN FACTS

China's Outbound Foreign Direct Investment

1. China's OFDI flows have grown significantly from less than $100 million in flows in the 1980s to $60.18 billion in 2010. China is currently the 5th largest originator of OFDI by flow volume.
2. Chinese OFDI still remains relatively small compared to other economies. In 2010 China's cumulative OFDI stock abroad reached $317.21 billion, ranking 17th among all economies.
3. Chinese outward investment activities are often directed by the Chinese government. When global OFDI drastically fell by 43 percent in 2009, buoyed by Chinese government financial support, Chinese OFDI still grew by 1 percent.
4. Merger and acquisition (M&A) data suggests that between 60 to 70 percent of cumulative Chinese OFDI can be attributed to M&A deals, with the top three deals accounting for over 2/3 of the total M&A volume.
5. As of 2010, there were Chinese overseas investments in 177 countries or territories. More than 72 percent of cumulative Chinese OFDI is located in Asia, though recent trends have seen growing investment in Latin America and Europe as Chinese companies look towards acquiring raw materials, infrastructure projects, and new technologies.

Sources: MOFCOM, USCC, Peterson Institute for International Economics, UNCTAD

The *Freeman Report* is an electronic newsletter produced monthly by the Freeman Chair in China Studies at the Center for Strategic and International Studies (CSIS), a private, tax exempt institution focusing on international public policy issues. Its research is nonpartisan and nonproprietary. CSIS does not take specific policy positions; accordingly, all views, positions, and conclusions expressed in this publication should be understood to be those of the author(s). © 2010, Center for Strategic and International Studies. All rights reserved.

FREEMAN CHAIR IN CHINA STUDIES

Charles W. Freeman III, Chairholder
Bonnie S. Glaser, Senior Fellow
Savina Rupani, Program Coordinator
Xiaoqing Lu Boynton, Fellow
Zhang Chun, Visiting Fellow
Brittany Billingsley, Research Associate and Program Coordinator
Jeffrey Bean, Research Assistant
Nathan Harpainter, Rory Lin, James Pearse, and Wen Yuan, Research Interns