

# **A Strategic Economic Engagement**

## **Strengthening U.S.-Chinese Ties**

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Summary: The prosperity of the United States and China depends on helping China further integrate into the global economic system.

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One of the first challenges the next U.S. president will face will be how to respond to China's emergence as a global power. Some people suggest that China is a threat that must be countered or contained. Others argue that its growth is an opportunity for the U.S. economy and that Washington should manage this rising power through engagement. I believe that engagement is the only path to success.

President George W. Bush chose this approach, and it has been successful. U.S.-Chinese relations are more productive today than ever before, partly because President Bush engaged Beijing and did so based on the recognition of China's twin priorities: territorial integrity and economic growth. Even if it were possible to block China's growth, it would not be in the United States' interest to try. China's rapid emergence as a global economic power presents numerous challenges on issues ranging from trade and investment to commodity markets and the environment. But the inextricable interdependence of China's growth and that of the global economy requires a policy of engagement. In fact, the overriding importance of economic growth to China's leaders presents the best means of influencing China's emergence as a global power and encouraging its integration into the international system.

To be effective, however, Washington must first understand Beijing's interests and the challenges it faces. The Chinese see economic growth as essential to their stability. Three decades of economic development have transformed their country, bringing it peace and stability and lifting hundreds of millions of people out of poverty. The Chinese are deeply proud of these accomplishments yet are concerned about their ability to sustain them. Their leaders, meanwhile, realize that China's future growth depends on its increasing integration into global trade, investment, and financial markets.

The United States and China share many interests, but as is inevitable in any broad and complex relationship, they also have significant differences. When it comes to China's military modernization, its enforcement of intellectual property rights, and its human rights record, Washington and Beijing have strongly diverging views and sometimes competing interests. On such issues, Washington must be both direct and vigilant in its efforts to advance U.S. interests bilaterally or, where appropriate, multilaterally. Such an approach will invariably create tensions, as it sometimes does in the United States' relations with other countries. But differences with China must not be allowed to stand in the way of progress and cooperation.

The United States and China -- and, indeed, the international community -- share a powerful interest in China's successful integration into the global economic system. The prosperity of both nations depends on the ability of each to achieve balanced economic growth, on stable and vibrant trade and financial regimes, on diverse and dependable energy sources, and on sustainable progress that protects human health and the environment.

### UNDERSTANDING CHINA

In 2006, President Bush and Chinese President Hu Jintao launched the U.S.-China Strategic Economic Dialogue (SED) to manage both immediate tensions between the two countries and their expanding relationship over the long term. The approach has worked, largely because it has recognized China's realities -- seeing the country as it actually is, not as many Americans imagine it to be. Washington understands, for example, that robust and sustained economic growth is a social imperative for China and that Beijing views its international interactions primarily through an economic lens. Hence, approaching Beijing through economic issues of interest to both countries is an effective way to produce tangible results in economic and noneconomic areas.

Perhaps as a consequence of their troubled memories of the central planning, autarky, and mass mobilization of

a few decades ago, China's leaders today are committed to reform, at least so long as it improves the country's political and economic stability. Every Chinese official older than the age of 50 experienced the calamities of the Great Leap Forward and the Cultural Revolution. In a country now so dynamic that entire blocks can be demolished and rebuilt in two weeks, people are searching for stability and balance. President Hu has said that it is the Chinese government's job to ensure "harmony," and this belief has reinforced Beijing's tendency toward caution in decision-making. Thus, with every policy, Beijing considers whether it is riskier to move too quickly or too slowly down the path of reform. The challenge for Washington is to understand China's perception of its self-interest, identify opportunities to persuade China that its interests and those of the United States often are the same, and narrow real differences whenever possible.

Despite the two countries' long history of interaction, they frequently display a stunning ability to misunderstand each other. A productive relationship requires that U.S. and Chinese policymakers engage at the highest levels in ways that lessen misperceptions and miscommunications. The SED accomplishes this by focusing on dialogues between top-level officials who treat one another as equals and engage on issues at the strategic level. For example, a bilateral air-services agreement was concluded during the second SED meeting, in May 2007. Lower-level negotiations on such an agreement had been stalled for some time because China was focused on developing the competitiveness of its domestic aviation industry and limiting international competition. But through the SED, I brought this issue to the attention of my counterpart, then Vice Premier Wu Yi, and explained how the increased exchange of people and goods between our two countries would strengthen their relationship. Thanks to the agreement, U.S. passenger flights to and from China will more than double by 2012, and air-cargo companies from both countries will enjoy full liberalization of the industry, including the lifting of restrictions on the frequency and price of flights, by 2011.

## EQUALITY AND TRUST

The Chinese are proud of their country's emergence on the world stage and rightly seek credit for its accomplishments. After nearly two centuries of exploitation by foreign powers, China feels it is important to defend its national interests, particularly against foreign demands. Unfortunately, the United States has often been perceived as arrogant and aggressive in its interactions with China, even when it has pursued legitimate interests.

U.S. officials are more effective when they understand the Chinese people's perspective. This is one reason why I travel to China so often; nothing can substitute for personal interactions with top decision-makers, especially in China, where respect and friendship are particularly prized. My counterparts in the SED, Vice Premier Wang Qishan and, before him, then Vice Premier Wu, have emphasized the importance of mutual trust. Establishing relationships at the top of the Chinese government has been key to the U.S. government's success with the SED.

One of the reasons relationship building is so important is that government decisions in China are often made by consensus and after much consultation. Reform progresses best when an umbrella of support at the top facilitates change at lower levels. Officially, the most important decisions are made by President Hu and Premier Wen Jiabao, but unofficially, decisions are increasingly made through a consensus-oriented process involving powerful government ministries. The SED's high-level, cross-agency approach recognizes this reality and brings key decision-makers to the table to build broad support for reform.

When the SED was first launched, in September 2006, few believed much progress would be possible. I was warned, by people in the United States and China, that the timing could not be worse to discuss economic issues. The 2006 U.S. midterm elections were just months away, the U.S. presidential campaign was already taking shape, and Beijing was preparing to appoint a new generation of leaders. Nevertheless, I believed direct engagement was the only way forward: there were too many critical issues between the United States and China that simply could not be allowed to drift without strategic direction.

The result was the SED, which is led at the vice-premier level in China and by the lead economic cabinet secretary on the U.S. side, and there is cabinet-level representation from all ministries with responsibilities for economic issues. To break down traditional government silos, Chinese ministers and U.S. cabinet secretaries participate in every session, all of which my Chinese counterpart and I lead. Discussions cover a variety of strategic issues, of both immediate and long-term concern, and are mostly unstructured. Unlike in other U.S.-Chinese economic dialogues, in the SED each side's commitments are recorded and publicized at the end of the sessions and then meticulously followed up on at the highest levels to ensure that they are fully implemented.

Recognizing that the active support and engagement of the president's office on broader economic questions is very important in both countries, twice a year the U.S. and Chinese governments hold cabinet-level meetings, which include the president of the host country. I have had regular and welcome access to President Hu and Premier Wen to talk about the most important economic issues in the U.S.-Chinese relationship. In August 2007, I discussed the adverse impact of economic nationalism in both the United States and China with President Hu. I believe that our candid discussion, which focused on areas of mutual interest, such as keeping each country's market open to the other's trade and investment, gave President Hu a better understanding of why China's growth and stability depend on its moving forward with liberalization, despite resistance from its domestic industry.

The SED's interagency approach also allows all the ministers and cabinet officials to hear arguments from all sides, and that, in turn, informs the decision-making process. For example, the governor of the People's Bank of China, Zhou Xiaochuan, does not decide the pace of the renminbi's appreciation on his own; through the SED, all the ministers involved in that decision can discuss it with the U.S. representatives. During the second SED meeting, in Washington in May 2007, the chair of the Federal Reserve, Ben Bernanke, highlighted to 15 Chinese ministers the urgency of rebalancing China's growth and reforming its exchange-rate policy. Seldom in the history of U.S.-Chinese relations has there been such an opportunity to speak directly to the entire Chinese economic leadership at once on such a pressing economic challenge. Likewise, the U.S. cabinet's understanding of China improves when it hears firsthand top Chinese policymakers explain the rationales for their positions.

Encouraging communication across stovepiped bureaucracies maximizes results. Before the SED's December 2007 meeting, China's State Environmental Protection Agency, or SEPA (since upgraded to the Ministry of Environmental Protection), had been working with the U.S. Environmental Protection Agency for years on an emissions-trading program for sulfur dioxide in China. It had conducted pilot projects at the local level but had been unsuccessful in expanding the effort nationally. After the SED brought the discussion to key offices of China's State Council, relevant Chinese ministries, and opinion leaders and companies in China, it helped SEPA gain broad support among the senior Chinese leadership, paving the way for Beijing to announce at the third SED meeting, in December 2007, that it would develop a nationwide program on sulfur-dioxide-emissions trading in the power sector. This was a meaningful step toward using market forces to address pollution and provide cleaner air in China. The move will also expand U.S. export markets and create jobs for U.S. environmental companies, which lead the world in developing the kinds of technologies necessary for such a program.

## OVERLAPPING INTERESTS

By focusing on policy areas in which China's reform agenda intersects with U.S. interests, the SED has found new and constructive ways to discuss some of the most important and contentious matters in the U.S.-Chinese economic relationship, including growth imbalances, energy security and environmental sustainability, trade and investment issues (including product safety), and China's position in the global economic system. Addressing these questions not only serves the interests of the Chinese people but also is vital to both the economic strength of the United States (which welcomes access to this important export market) and the continued strength of the global economy. Americans who worry that China might overtake the United States are worrying about the wrong thing. They should instead be concerned that Beijing may not make key reforms or that it will face significant economic difficulties down the road. Serious troubles in China's economy could threaten the stability of the U.S. and global economies.

Despite the emergence of China as a global economic power -- it now has the fourth-largest GDP in the world -- it is still a developing country, ranking only one-hundredth in the world in per capita GDP. China's income growth has been widespread but uneven; consequently, income inequality has risen sharply in the last three decades. One indicator of this inequality is enrollment rates in China's provincial high schools, for which parents must pay fees. Earlier in the reform era, there were only small differences in such rates across provinces, but by 2003 enrollment was nearing 100 percent in the wealthier provinces, compared with less than 40 percent in the poorer ones. With China's social stability anchored in the belief that the wealth boom will eventually filter down to everyone, continued growth remains Chinese leaders' most important priority. But the challenges of sustaining growth and reducing income inequality are becoming more formidable as China's economy grows more complex, its exports begin to saturate overseas markets, its population ages, and domestic demands for a clean environment intensify.

Ironically, it is precisely the growth model that spurred China's recent takeoff that may become an obstacle to the country's sustained economic growth and social stability in the future. Over the last four decades, all emerging markets in East Asia have seen their industrial sectors grow, and many have also experienced increases in income inequality. But these shifts have been much greater in China. The country's heavy reliance on exports and investments in its capital-intensive manufacturing industry in order to support growth has promoted the rapid rise of energy consumption (as well as environmental damage), the building up of coastal areas far faster than the country's interior (where 740 million people, or more than half of the population, live), and a dramatic increase in China's trade surplus (which has heightened tensions with its trading partners).

One of the most notable indications of China's imbalanced growth is its large current account surplus, which last year amounted to over 11 percent of the country's GDP. This reflects the fact that China spends much less than it produces and earns and that it has a high rate of national saving. Chinese household consumption was only 35 percent of GDP in 2007, down from roughly 50 percent 30 years ago, when Beijing started market reforms. (Household consumption is roughly 70 percent of GDP in the United States and 60 percent in India.) On the other hand, household savings are high, as individual Chinese try to compensate for the country's thin social safety net, limited options to finance major expenditures such as education, and few investment options other than bank deposits. Demographics will only exacerbate these trends: as China's population ages, the traditional source of support in retirement -- children -- will become increasingly scarce.

China must further develop its financial sector to help reduce this excessive personal savings rate and boost personal consumption. With more financial products and services available to fund major expenditures and insure against misfortune, and with investment options yielding higher returns, Chinese households will be in a position to save less and consume more. A more dynamic and competitive financial sector would also channel resources for investment into the new, less capital-intensive industries, such as the services and information industries, that will drive China's growth in the future.

In order to ensure stable, noninflationary growth in the short term and sustainable growth in the long term, China also needs flexible prices and, in particular, a flexible exchange rate. Beijing's tight management of the renminbi, coupled with its large trade surplus and large capital inflows, has led to a staggering accumulation of foreign exchange reserves -- now totaling over \$1.8 trillion. This has prompted the People's Bank of China to issue massive amounts of renminbi so that it can buy up the foreign exchange reserves and keep the currency from appreciating too rapidly -- and that, in turn, has helped fuel inflation despite the central bank's efforts to absorb the excess money by selling bonds and raising bank reserve requirements. Currency appreciation and greater flexibility in China's exchange rate could limit the impact of rising world oil and commodity prices on prices in China and at the same time allow Chinese monetary policy to be a more effective tool for ensuring stable growth. A stronger renminbi would also encourage economic activity in the sectors of the Chinese economy -- particularly services -- that produce for the domestic market. And this would help raise the share of household consumption in China's economy, increasing the role of domestic demand in powering China's growth and making that growth more sustainable in the future.

These issues have been at the center of many SED discussions. As a result of such talks, China's leaders have come to recognize the value of exchange-rate adjustment, in particular, and have significantly accelerated the pace of the renminbi's appreciation. Between July 2005, when the Chinese government first unpegged the renminbi from the U.S. dollar, and mid-June 2008, Beijing allowed the renminbi to appreciate against the dollar by 20 percent on a nominal basis and 23 percent on a real basis. Seventy percent of that appreciation has occurred since the SED began, and half of it over the past year alone. China clearly has much further to go, but the progress to date is an example of how strategic dialogue can yield results.

Thanks to the SED, Washington has worked steadily to help Beijing open China's financial sector, creating new opportunities for Chinese institutions to invest abroad and for U.S. banking, securities, and insurance companies to operate in China, including by enabling them to invest in China's stock markets. U.S. and other foreign financial institutions are industry leaders in China, but they face domestic competitors pushing for protection. The SED continues to explore paths by which the Chinese government can further liberalize China's financial sector, including allowing foreign companies to issue renminbi-denominated stocks and bonds and expanding the permitted scope of business for foreign securities firms.

## POWERFUL CHALLENGES

As the two largest consumers and two of the largest importers of oil in the world, the United States and China are natural allies when it comes to energy security. The United States has adopted pro-market policies, pushed for transparency in energy supply and demand, and promoted the development of alternative energy sources, and it has encouraged China to do the same. Yet the United States is still urgently in need of a comprehensive energy policy to ensure its energy security. And so is China. In fact, if China today were as efficient as the United States was in 1970, it would save the equivalent of 16 million barrels of oil a day, or almost 20 percent of the world's daily oil consumption.

There are signs of change. After years of viewing energy as merely an input for economic growth, the Chinese government now increasingly recognizes the need to proactively manage its energy demand. Three key factors have motivated this transition. The first is economic. China has typically set price caps on electricity and subsidized oil in an attempt to promote social stability, but such artificially low prices have encouraged inefficient and wasteful consumption, even as the cost of these programs to the government has increased with rising global energy prices. As a result, the country now faces continued gasoline and diesel shortages, and in times of crisis, the government can no longer ensure a steady supply of energy to its people -- as happened during the snowstorms of early 2008.

Second, China's leaders have recognized that resource scarcity constrains their ability to maintain political stability by improving the population's quality of life. They now realize the need to develop a new, low-energy model of economic growth. There simply are not enough energy resources to allow the world's entire population, or even the third of it represented by the Chinese, to lead the resource-intensive lifestyle that Americans currently enjoy. A way to support higher incomes while placing less of a burden on resources must be found.

The third reason Beijing is increasingly aware of the need to control energy demand is growing popular concern, especially among the middle and upper-middle classes in China, over the environmental degradation caused by inefficient energy use. Approximately 1,000 disputes over environmental protection occur each week in China. Environmental damage there is so severe that according to World Bank estimates, the combined health and nonhealth costs of air and water pollution in China amount to \$100 billion a year, or about 5.8 percent of the country's GDP.

Despite the international concern linking China's energy and environmental challenges to climate change, this is not yet a pressure point for Beijing. China's leaders are acutely aware of the enormity of the problem and of its costs to China, be they floods and other natural disasters or the threat of rising sea levels to the country's coastal cities. But they face more pressing short-term, localized environmental issues -- such as polluted water and air, which compromise their people's health -- and they view climate change as a problem created by industrialized countries and hence one for those countries to solve. Beijing still views international discussions and negotiations on the topic as opportunities to get other countries to pay it to reduce the environmental impact of China's economic growth. Existing agreements have given Beijing reason to hope for success with this strategy: in 2007, China received 73 percent of the carbon credits available under the Clean Development Mechanism, a feature of the Kyoto Protocol that allows industrialized states to meet their obligations under the treaty by funding emissions-reduction projects in developing countries.

As China becomes the world's largest and fastest-growing emitter of carbon, the rest of the international community is recognizing that it cannot meet its goals on climate change without a major undertaking by Beijing. Fortunately, there is a constructive path forward. As China makes progress on its immediate energy and environmental challenges by making its economy less energy-intensive through the implementation of low-carbon policies, strategies, and technologies, a corollary benefit will be a reduction in the growth rate of its carbon emissions. And given China's growing role in the global economy, it will soon become clear, first to the rest of the world and then to Beijing, that the Chinese government must assume more responsibility for meeting the challenge of climate change.

Meanwhile, even as the United States and other countries grapple with multilateral treaty negotiations on climate change, the SED has focused its bilateral discussions on the costs of climate change to the United States and China. The ramifications of China's energy policies have been a consistent topic of discussion at the SED, and I have encouraged the Chinese government to move toward a market-determined price for energy. Beijing has had a plan for introducing additional market prices in the energy sector for some time but has been concerned about the instability that such a measure could cause. Beijing's decision to raise fuel prices and eliminate subsidies last June, immediately after the SED's fourth meeting and during a visit by Vice Premier

Wang to Washington, was the right move: it is critical for China's stability that such reforms be made while China's economy is strong.

The United States and China recognize that both energy security and environmental protection are crucial for their sustainable development. Although the two countries have different needs and face different challenges, they both want to achieve energy security while maintaining a healthy environment. Out of this shared recognition has come one of the SED's major achievements: the signing of the Ten Year Energy and Environment Cooperation Framework at the SED last June. This framework is a bilateral mechanism focused on creating a new energy-efficient model for sustainable economic development and on addressing the factors that cause climate change through concrete actions. Recognizing that such problems are too big for either government to fix alone, the initiative involves all levels of government, business, and other sectors of society in both countries and focuses on the development and implementation of new technology, the review of current policies, the development of new regulatory and enforcement capacities, and public education. The framework has produced tangible results in the areas of electricity production and transmission, water and air quality, transportation, and forest and wetland conservation -- suggesting the promise that future cooperation between the United States and China holds. Through the framework, the United States and China are already cooperating on joint research on alternative and renewable fuels for transportation and on efforts to improve the water quality of China's rivers, lakes, and streams. Even greater breakthroughs could lie in the years ahead, and this framework provides the next U.S. administration with a critically important foundation on which to continue Washington's economic engagement with China.

## TRADE AND INVESTMENT

Trade and investment, once the glue of U.S.-Chinese relations, today represent a source of tension. China's recent economic reform placed the country on a clear path toward becoming a modern economy, and although it has not veered off that path, it no longer clearly embraces the elements necessary to complete its transformation. Exploiting popular anxieties about globalization, economic nationalists in China are questioning the benefits of China's integration into the international economic system.

Beijing has recently adopted policies that seek to restrict foreign access to China's markets, including a new antimonopoly law. Although much will ultimately depend on how this law is implemented, it appears to favor some of the large companies that lead domestic industries, which the Chinese government promotes as "national champions." China's foreign-investment regulations are opaque and increasingly restrictive, and the government continues to grant major subsidies to key domestic industrial sectors. Heavy lobbying by local authorities and by profitable and powerful Chinese businesses is shaping Beijing's industrial policy. As a result, both large U.S. corporations (longtime proponents of bilateral engagement) and smaller U.S. businesses (which are eager to enter new markets in China) are growing concerned about the lack of openness to U.S. products in China. And those U.S. companies with major investments in China have no consistent way to protect them.

Thus, the launching of negotiations for a bilateral investment treaty during the June 2008 SED meeting was particularly important for both countries, as such a treaty would protect the large amount of U.S. investment in China and open up new opportunities for U.S. investors while encouraging more Chinese investment in the United States. The initiative was also significant because China, as the greatest beneficiary of the market reforms it has undertaken, has the most to lose from slowing down or reversing these reforms, and the initiative would keep it on the reform track. As the United States itself has learned, promoting competition and innovation, especially through the protection of intellectual property rights and the advancement of transparency and the rule of law, is essential to sustaining robust economic growth in the long term.

There are serious obstacles ahead, however. Economic nationalism, for one thing, has been a growing concern in the United States in recent years. Low-cost imports, particularly from China, sometimes have a negative image among the American public, even though they have helped the United States contain inflation and both maximized the choice of products available to Americans and minimized their costs. Foreign investment into the United States, especially by sovereign wealth funds and state-owned enterprises, is also increasingly viewed with suspicion by some U.S. companies, various members of the national security community, and the American public at large, despite regulations by the Committee on Foreign Investment in the United States that provide sufficient protections in sensitive sectors.

These concerns are misplaced. Like many countries accumulating large foreign exchange reserves, China is

simply looking for profitable places to invest them over the long term. China invests its reserves in U.S. securities, including U.S. Treasuries, but there is little Chinese direct investment in the United States. This is largely because Chinese companies are just beginning to invest in their export markets and are unsure whether they are welcome. In any event, the United States would do well to encourage such investment from anywhere in the world -- including China -- because it represents a vote of confidence in the U.S. economy and it promotes growth, jobs, and productivity in the United States.

The size of the bilateral trade imbalance -- \$256.2 billion in 2007 -- has also been a bone of contention. It is a source of anxiety in both the United States and China. Beijing believes that the trade deficit could be reduced if Washington dropped export controls and allowed sensitive technologies that may also have military applications to reach Chinese markets. In fact, U.S. export controls have only a marginal effect on the bilateral trade imbalance: in 2007, export license applications were required for \$9.7 billion worth of U.S. goods destined for China, and just 0.7 percent of these applications were denied -- a drop in the bucket. Removing all export controls in 2007 would have affected only 0.0265 percent of the U.S.-Chinese trade deficit.

A real issue is the inadequate protection of intellectual property rights in China, which has been an obstacle to increased U.S. trade with and investment in China and has prevented a reduction in the bilateral trade imbalance. This and the theft or pirating of goods are big problems for many U.S. companies operating in China and a reason others are reluctant to do business there. To protect themselves, some U.S. companies purposefully introduce older products into the Chinese market, releasing the newer goods only once the older ones have been copied.

But these and other strategies are merely stopgap measures. As China pursues its quest to develop a modern economy focused on technology, the Chinese government and Chinese companies will increasingly recognize the need to reward the creativity of their own firms and entrepreneurs by strengthening and enforcing intellectual property laws and regulations. It is by improving and enforcing its intellectual property laws that China will accelerate the development and competitiveness of its economy and also open up new market opportunities in China for companies around the world.

## CHINA AND THE GLOBAL ECONOMY

China's return to the world stage as a global economic power has greater consequences than the rise of other nations with comparable per capita incomes. This is partly because few economies at China's level of development have had to address such a complex array of regulatory and governance challenges. Major developed economies are demanding that China do more than most developing nations at an equivalent stage of development. Given its substantial impact on the global economy, China must accept greater responsibilities. If it does not, other countries are likely to blame it for many of their own economic problems. China is already cited as an example of the ills of globalization, such as unsafe products and job losses in other countries. It risks further endangering its reputation, which could hurt its economic growth in the long term. As a country deeply invested in the global economic system, China would benefit from playing an increasingly proactive role in global economic decision-making. And yet it seems to be doing the opposite in the Doha Round of international trade negotiations. Its insistence on protecting its own industrial development is driving other countries to do the same and has been a major factor in the growing antiglobalization and protectionist sentiment around the world.

This point notwithstanding, China's diplomacy has been more effective than is often acknowledged. China has been deft in exercising its soft power to advance its economic interests around the world. In 2006, it hosted the first summit and third ministerial conference of the Forum on China-Africa Cooperation, inviting delegations from nearly 50 countries in Africa to Beijing for a weeklong celebration of China's growing relationship with the continent. At the conference's conclusion, Beijing pledged to unconditionally double its aid to Africa by 2009 -- thus indirectly opening the door to additional Chinese investment in the continent. China's bilateral engagement has generally focused on developing mutually beneficial economic objectives. Some of the resulting relationships, such as those with Angola and Sudan, have occasionally been at odds with international norms or have undermined the World Bank's efforts to promote transparency. But Beijing now recognizes that its future economic growth is tied to the continued success of the global system, and it is beginning to contribute more to the international community. It is becoming a more responsible trading and investment partner in Africa and Latin America, for example. In 2007, China contributed for the first time to the International Development Association, the branch of the World Bank that provides grants and low-interest credit to the world's poorest countries. It now collaborates with the World Bank on projects in Africa. It has recently joined the Financial

Action Task Force, the multilateral organization that assesses countries' efforts to combat money laundering and terrorist financing. And it is in talks to join the Inter-American Development Bank. U.S. officials have encouraged these efforts through the SED and so facilitated China's integration into the global economic system.

Beijing has recently realized some of the unpleasant implications of working outside the global economic system, especially in the energy sector. It has tended to pursue a mercantilist policy regarding energy security in an attempt to protect itself against the price fluctuations and supply disruptions intrinsic to the global oil market. But its attempts to lock in oil supplies by investing in facilities in troubled countries such as Iran and Sudan have not succeeded. China has paid above-market prices for overseas exploration and extraction projects, and these efforts have helped it meet only five percent of its demand in imported oil; it still depends on global markets to meet the remaining 95 percent. China is simply too large a nation with too great a domestic demand to buy its way to energy security. Moreover, as Beijing has recently begun to recognize, the cost of doing business with sketchy governments comes at a substantial political price. China's investments in Sudan, for example, have tarnished its international reputation. Concerns have emerged among the Chinese people, too, after several Chinese citizens were caught and killed by Sudanese rebels in Darfur. Likewise, as Tehran continues to face censure for its nuclear-development activities, Beijing is gradually realizing that doing business in Iran is becoming increasingly complex and increasingly costly to its image.

Like China's top officials, China's business leaders have begun to recognize the negative impact of China's reputation as an opportunist. The China National Offshore Oil Corporation, or CNOOC, has been paying more and more attention to social responsibility and is making it one of the tenets of the company's oil-exploration activities around the world. Through the SED, the U.S. government has worked to foster Beijing's awareness that China, like the United States, is a stakeholder in the global economic system. Washington has encouraged Beijing, for instance, to join the Congo Basin Forest Partnership, an initiative that promotes the sustainable management of resources in the Congo River Basin. And these efforts are making a difference. At the SED meeting last June, the two governments agreed for the first time to work together to promote global sustainable forest management. Change is occurring as Beijing recognizes the benefits of participating in and contributing to the international system.

## LOOKING AHEAD

Going forward, there are three possible ways for the United States and China to pursue their economic and trade relations: robust engagement, dispute resolution through multilateral and bilateral enforcement measures, or punitive legislation. Since a retributive policy would be counterproductive and would harm U.S. economic interests, the U.S. government has chosen the first two approaches.

And rightly so. Since Washington stepped up its economic engagement with Beijing through the SED two years ago, the U.S.-Chinese relationship has deepened and expanded. By encouraging top-level discussions of the two countries' long-term strategic priorities, the SED has found effective ways to manage short-term tensions surrounding trade disputes. It has alleviated a complex set of concerns in the U.S. Congress in a way that has led to a significant appreciation of the renminbi and forestalled dangerous protectionist legislation. At the same time that U.S. consumers were growing deeply concerned about product safety, the SED developed a comprehensive plan for improving the quality and regulatory oversight of foods and drugs imported from China (the effort could even serve as a global model for product safety). And as the world was becoming more eager to reduce its dependence on oil, the SED initiated the Ten Year Energy and Environment Cooperation Framework to help expedite the United States' and China's efforts to increase their energy efficiency. The SED has enabled progress on significant noneconomic issues and more progress on economic issues than otherwise would have occurred.

These successes have created a foundation of mutual understanding and trust and a platform for further progress. History has shown that the ties between the United States and China have been most stable and mutually beneficial when a common interest has united leaders in Washington and Beijing. During the Cold War, balancing the Soviet Union's power in Asia was that shared interest. It generated trust for a very young U.S.-Chinese relationship and facilitated substantial bilateral cooperation. Now, the SED has reoriented U.S.-Chinese relations based on the strategic rationale of sustaining global economic growth. This unifying theme will motivate policymakers in both countries and offers the chance to redefine the terms of the two countries' relationship from simple cooperation to joint management and, perhaps eventually, even genuine partnership. Such a recasting will be an invitation to China to participate in global affairs as an equal -- a



position that Beijing covets.

I have learned firsthand that the United States is much more effective at resolving global issues when it approaches them multilaterally rather than unilaterally. On every major economic, political, and security issue, the path that China chooses will affect the United States' ability to achieve its goals. This will also be true under the next U.S. administration. The SED must be used to help manage the myriad economic issues that will undoubtedly arise and help keep the vital U.S.-Chinese relationship on an even keel, productively advancing shared interests while working through enduring differences. It is possible to manage these challenges in a way that advances both U.S. and Chinese interests. And it is my hope that the next U.S. president will expand on the SED to take U.S.-Chinese relations to the next level.

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