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The Rise of China: Policies of the EU, Russia and the US

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The EU and the Rise of China

Daniel Gros¹

The EU should have no ideological problem in recognising the emerging power of China since it is not a major power itself (beyond the area of economics), so the rise of China should not create any particular friction within the EU.

Moreover, while both the EU and China dominate their respective ‘near abroads’, their two spheres of influence do not overlap, which further reduces the potential for conflict.

It is misleading to speak of an ‘EU position’ towards China, however. A key determinant of the European position(s) towards the emerging economic power of China remains the incomplete internal institutional framework of the EU, which in many fields makes it very difficult to formulate and actively implement a coherent policy towards China. This has led to a distribution of roles whereby actors with little influence on actual foreign policy decisions (the EP, NGOs, national parliaments) specialise in symbolic gestures, and the actual hard policy decisions taken at the national and EU levels are mainly determined by perceived self interest.

The lack of an EU position is particularly evident in the representation of ‘Europe’ in international organisations, especially the IFIs, like the IMF and the World Bank. In principle it is clear that in these institutions a smaller representation of European countries and a much larger one for China is warranted. The EU institutions agree on this (in private), but member states are not yet ready to formally acknowledge their diminished global role, although in reality they recognise their limited influence.

The two exceptions to the rule that the EU does not have a China policy are in the areas of trade and (soon) the environment. China is already the biggest emitter of greenhouse gases (mainly CO₂) and given its extensive, energy-intensive growth its emissions are certain to continue growing. Its contribution to global warming cannot be ignored and this is one key area where the EU (together with the US) needs to engage China constructively in order to avoid an open conflict. A successful compromise will require careful diplomacy on all sides: the EU, China and the US, whose conversion to cap and trade remains a necessary condition for the EU’s scheme to work properly. However, the EU’s institutional set up seems to be well prepared for this particular issue.

The EU’s peculiar institutional configuration also implies that European ‘China bashing’ comes mainly from member states where, depending on the national context, leaders find it convenient to blame China for the economic difficulties of the moment. However, since conditions vary so much across member states ‘China bashing’ seldom comes from a large majority of member states at the same time and thus is very much less likely to lead to action against China than in the US, where populist policy stances can be more easily picked up by the federal institutions (Congress or the President). It is thus unlikely that the EU will assume an overall confrontational stance vis-à-vis China.

Outside the area of economics there is even less reason to anticipate conflict between the EU and China for the simple reason that the EU as such does not have a great power position to defend (and its member countries have long given up the pretence of being great powers themselves). Hence it is difficult to imagine a coherent EU policy towards the rise of China. Member states will, over time, have to acknowledge that China is an increasingly important actor in many parts of the world, but they all pursue their own, national policies towards China, which are mainly determined by the national equilibrium between the interests of traders and human rights activists, with the interests of the former usually prevailing over the latter. Other national constituencies take scant interest in China.

¹ Daniel Gros is the Director of the Centre for European Policy Studies (CEPS).

The remainder of this note concerns the economic issues that make up most of the substance of the EU-China relationship.

Today the major sources of friction in the field of economic policy concern imports of labour-intensive products and China's large trade surplus. The first source of friction is likely to wane rapidly with the shift towards relatively capital-intensive production methods in China. However, the second source of friction is likely to persist as exports continue to be the main driver of demand and growth in China. But this seems to be more of an issue between the US and China, given that Europe is likely to continue to run a small current account surplus for the foreseeable future.

A key peculiarity of China's economy is its extraordinary degree of openness: exports amount to about 40% of GDP, a figure closer to the average of individual EU member countries, rather than the approximate 15% one observes for large economies like Japan, or the EU and US. This implies that in many cases the outlook of China on global economic issues might be quite similar to that of most member countries.

Moreover, about 60% of Chinese exports are generated by so-called 'foreign invested enterprises' (enterprises with a large foreign participation). Over one-half of the Chinese 'export machine' is thus managed by foreigners. This suggests that while China is likely to remain stubborn in the pursuit of its perceived national interests, it is unlikely to become a disruptive element in the world economy.

Furthermore, China is already one of the biggest capital exporters (capital exports are the mirror-image of its current account surpluses). This implies that China has a stake in the stability of the global financial system, but, as the events surrounding the rescue of US government-sponsored enterprises (Fannie Mae and Freddy Mac) showed, its stance remains rather passive since the accumulation of foreign assets occurred through foreign exchange market intervention at the central bank and central banks are always extremely conservative in their foreign investments, limiting themselves mostly to government (or quasi government) debt instruments. This is likely to change over time. As large Chinese corporations emerge they are increasingly likely to use their abundant and cheap funding to buy up assets around the world. It is thus conceivable that over the next decade many of the Western enterprises with strong investments in China will in turn have a large Chinese element in their capital base. All this is likely to strengthen the interest of China not only in an open and rules-based international trading system, but also an open global capital market. As a very large investor China must be interested in a rules-based framework for international finance because it might soon become the preferred target for restrictions on international capital flows.

The EU and China should thus have a similar overall stance in global economic affairs: a general preference for an open and rules-based system. But both also dominate their respective regions. The overall multilateralism will probably be punctured by a number of regional agreements.

The table below summarises the potential for a conflict of cooperation in the main areas of economic policy.

Table 1. Areas of conflict and cooperation between EU-China

	EU interests	Chinese interests	Likely outcome
Trade			Common support for WTO
Environment	Global reductions in emissions	Avoid constraint on growth	Conflict leading to compromise over trade measures
Energy	Secure supplies without paying a moral price	Secure supplies	Competition without animosity
Finance I: regulation	More global co-operation	Indifferent	Little contact
Finance II: SWF	Control over FDI	Avoid controls	Low level conflict
Finance III: representation in IFIs		Recognition of economic size	Internal conflict in EU: MS versus Commission

1. Economic fundamentals: China's place in the global economy

China and India are often mentioned in one breath as representing similar challenges for the EU (and indeed all OECD countries). However, the scale of the challenge from each of these two economies is not comparable. In terms of the sheer size of trade and investment flows the differences dwarf the similarities, as shown in Table 2 below. At current prices and exchange rates, the GDP of China is about twice that of India, and China exports nine times as many goods and still almost twice as many services. In terms of inward FDI, China is more than ten times larger than India.

Table 2. China and the 'West': Comparing size (\$ billion)

	GDP		Trade (exports)		Inward
	Current exchange rates	PPP	Goods	Services	FDI
China	2,600	5,000	970	92	78
EU 27	13,000	13,700	1330	192	

Sources: WEO database, Eurostat & International Comparison Programme (ICP) (2007) of the World Bank.

The raw data suggest that China on its own is big enough to have a strong impact on the global economy (and on the EU). In the area of international trade China is now on a par with the EU and the US. The importance of China for the global economy is likely to increase as the combination of a housing bust and financial crisis weakens the transatlantic economy. If the Chinese economy were to maintain the gap in growth rates (i.e. if the slow-down in China is not stronger than that in the US or Europe) China's economy would be roughly of a similar size in less than ten years. At that point the EU, the US and China would each account for about 20-25 % of global GDP. Moreover, if Chinese exports (and imports) were to continue to grow as they have done so over the last ten years, China alone would account for roughly one half of total world trade (and would export about 3 times as much as either the EU or the US). Past trends will not continue forever, but it is clear that even if they weaken the world trading system will increasingly revolve around China.

2. Capital accumulation as the key driver of growth in China

Will China actually be able to continue to grow at this rapid pace and thus to catch up with the advanced economies over the next decade? The main reason for assuming that this will be the case is that the key motor behind this catching-up process is a fundamental upgrading of the human and physical capital stock in China.

Both elements are equally important, but their upgrading is proceeding at somewhat different speeds:

Physical capital

Here the catching up process is quickest due to the extraordinarily high rate of savings in China.

For an economist the key measure for the capital stock is the capital/labour ratio, which to a large extent also determines the level of productivity and thus of wages. The key factor that dominates the evolution of the capital/labour ratio in China is the very high Chinese investment rate. While there is some debate over the measurement of the denominator (GDP), it is generally agreed that China invests more than 40% of its GDP (against about 20% for the EU and the US, and 25 % for India). This must be the starting point for any assessment of this issue.

FDI plays only a minor part in determining the overall resources devoted to investment since total FDI inflows represent only around 10% of all investment in China. The importance of FDI for China is thus not the amount of capital invested, but the transfer of technology that it brings about.

The direct consequence of the extraordinarily high rate of capital accumulation in China is that it leads to an unprecedented increase in the capital/labour ratio (a key determinant of productivity). Gros (2008) calculates that within 15 years China will have a similar capital/labour ratio as the EU, which will have major implications for economic relations between the EU and China. Most European

policy-makers still seem to be under the impression that imports from China are likely to threaten mainly labour-intensive industries, such as textiles and clothing. Given the extremely high investment rates in China, however, this is likely to change rather quickly. As the difference in capital/labour ratios is shrinking rapidly, the composition of Chinese exports should shift quickly as well; with Chinese exports becoming more capital (and energy) intensive.

Human capital

While the current policy concerns focus on cheap labour, there have been a number of press reports suggesting that China is rapidly catching up in terms of innovation activity. The raw data suggest, however, that concerns about China taking the lead in innovation activity on a broad scale are exaggerated. Moreover, in this area the speed at which China can close the gap with the EU is limited by demographic factors. With a roughly constant population, the average stock of human capital per worker can change only gradually as better-educated new generations replace the older ones. This is by definition a slow process.

The starting point in terms of human capital in China is not far from the EU average, but it is still clearly behind (with an average 6 years of schooling versus 8-10 years for most EU member countries). The level China has today is widely regarded as sufficient to build up a strong industrial base, but not to become a leader in innovation.

However, human capital accumulation is also accelerating at a very rapid pace in China as one can see from the enrolment ratios, especially in higher education. An indispensable input for R&D is a workforce with the appropriate level of education. Research and development is mostly undertaken by personnel with tertiary (university level) education. In China the enrolment rates in tertiary education are increasing at a very rapid pace, but the level reached in 2005 was still only 20%, much lower than the 56% recorded for the EU (and even further from the US ratio of 83%). Over the last 20 years there has been a jump in tertiary education in China, with enrolment ratios increasing by a factor of 7. But the starting point was so low that even today enrolment rates are below one-half of the European level.

As an aside, it is interesting to note that despite its reputation for strength in high-tech services, India has made much less progress than China (tertiary enrolment up only from 6 to 11%). The Indian software industry seems to constitute an exception that hides an average that has fallen way behind that of China.

The available data thus suggest that for some time the Chinese workforce will continue to lag behind that of the EU (and even more than that of the US) in terms of the percentage of younger cohorts that have a tertiary education.

The upgrading of the skills of the Chinese workforce is thus proceeding less quickly than is sometimes assumed. However, one needs to recall that the cohorts that are currently studying (and will soon enter the labour force) are also much more numerous in China (about 3 times as many) than in the EU. This implies that in absolute terms one should expect that China already produces as many university graduates (including engineers, which have been the focus of much attention) as the EU. Moreover, as enrolment rates are still increasing rapidly it is unavoidable that China will eventually overtake the EU (and the US) in terms of the number of scientists that graduate each year.

Table 3. Enrolment ratios, 1985-2005

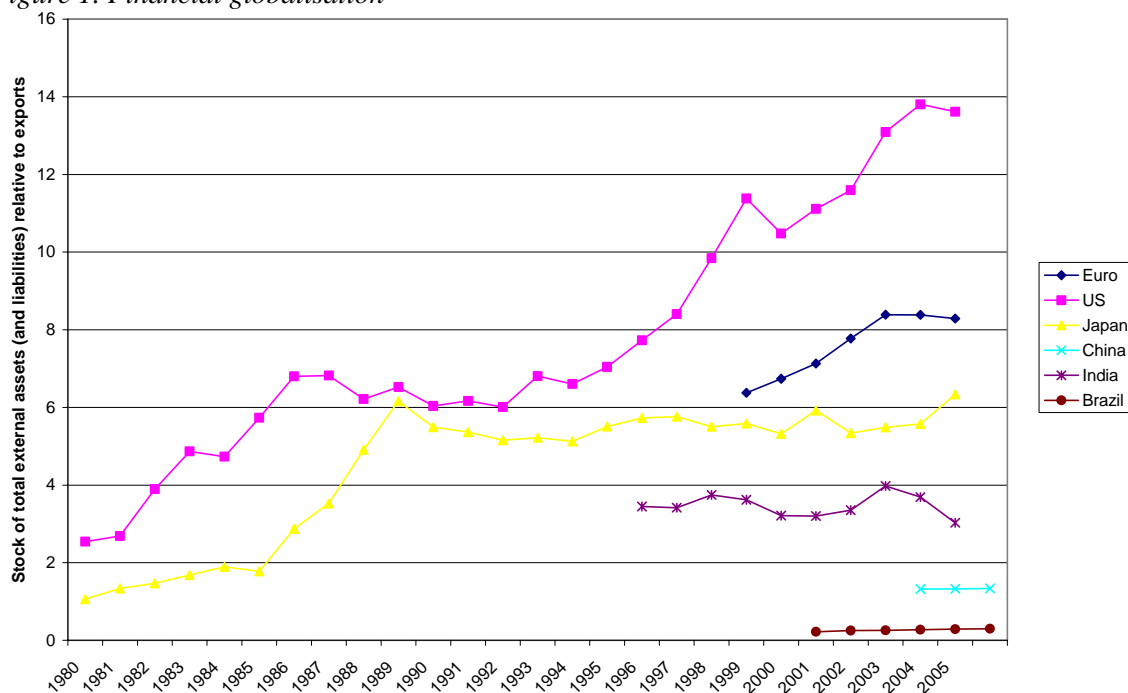
	Secondary education (Net)			Tertiary education (Gross)		
	1985	1995	2005	1985	1995	2005
China	39.7	65.8	74.3	2.9	5.3	20.3
United States	91.2	90	89	60.2	80.9	82.7
India	37.9	48.8	56.6	6	6.6	11.4
EU27 (average)	82.7	97.9	100.8	26.7	44.9	56.2

Source: World Bank.

3. Finance: China's absence

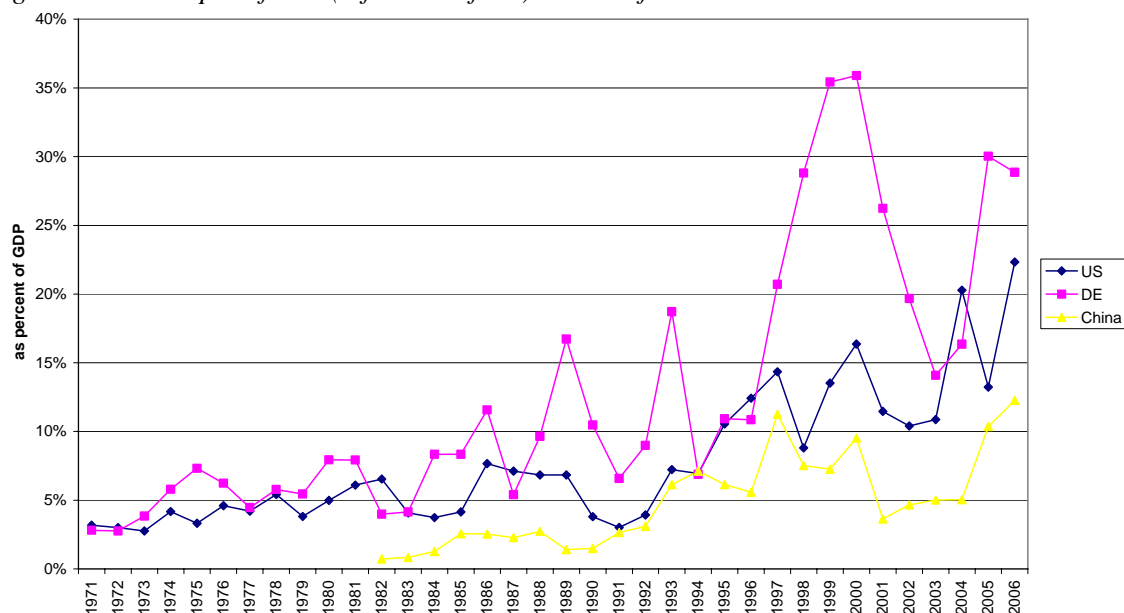
Although China is a giant in the field of trade it is still a dwarf in the area of finance. While China and the US are about the same size in terms of exports there is a huge difference in terms of financial openness: in absolute dollar terms the external assets and liabilities of the US are about ten times greater than those of China. And even measured against exports one can see from the chart below that China is much more interested in trade issues than in financial markets.

Figure 1. Financial globalisation



That China is also much less integrated in the global capital markets can also be seen from the importance of capital flows (as opposed to the stocks of foreign assets and liabilities), which for China amount to little more than 10% of GDP, compared to about 30% of GDP for the US. China's interest in constructing a new order for global financial markets is thus rather limited.

Figure 2. Total capital flows (inflow+outflow) as a % of GDP



4. Energy: China's carbon-rich economy

Another area in which China will be a dominant player on the global scene is greenhouse gas emissions. As shown in Table 4, China already consumes almost as much energy as the EU (1,700 million tonnes of oil equivalent (mtoe)/year versus 1,780), implying that its energy intensity (energy consumption per unit of output) is similar to that of the EU, at least if GDP is measured at PPP. However, the composition of China's energy consumption is quite different from that of the EU (or the US): China consumes almost four times as much coal as the EU. Moreover, if current trends continue, in 10 years China will consume 50% more energy than the EU. Most of the increase in energy demand is likely to continue to come from coal, which is relatively abundant in China.

Table 4. Energy consumption and composition (mtoe*)

	Primary energy consumption			Major fuels (2006)	
	1996	Today (2006)	Projected (2016)	Oil (net imports)	Coal (consumption)
EU	1691	1782	1878	720 (560)	320
US	2190	2326	2471	940 (608)	567
China	965	1698	2987	350 (169)	1,191
India	271	423	680	120 (80)	240

* Modification Table of Organization and Equipment.

Sources: BP (2007), World Energy Review.

China's self-sufficiency in coal has two implications:

- i) China is already the biggest source of CO₂ emissions (coal is much more intensive in CO₂ than the equivalent energy obtained through oil or gas).
- ii) China is much less dependent on hydrocarbon imports than either the EU or the US, and the price of coal has increased much less than that for either oil or gas. India resembles China in that it also has abundant coal reserves, but in terms of overall size, they are again much smaller, about one-quarter of those of China, with a total annual consumption of primary energy of about 400 mtoe.

Climate change is thus an area where considerable friction seems unavoidable. China will not be willing to accept any absolute limit on its emissions of CO₂. However, China also knows that if both the EU and the US introduce a 'cap and trade' system (which puts a visible price on carbon) its exports might be subject to 'border measures', i.e. an import tax on carbon content. Given China's huge stake in keeping its exports growing there might be room for a compromise in the sense that in exchange for keeping access to its two major markets China agrees to a specific set of other measures to limit domestic emissions of CO₂.

China will not be able to avoid a major policy clash (not only with the EU) on how to prevent global warming given that Chinese exports contain a substantial amount of all the CO₂ emitted in China (according to most estimates around one third). This implies that the EU cannot ignore the 'carbon leakage' that results if the EU puts a price on carbon, but major exporters do not do the same. This leaves the EU with only the choice to tax the carbon content of its imports. Such a policy could most probably be made WTO-compatible; implying that membership in this organisation will afford little protection to China. Furthermore, own calculations indicate that the tariff rate that would result from taxing the CO₂ content of imports would be around 8%, which would constitute a substantial hurdle for Chinese exports, which still contain large amounts of CO₂. The Chinese leadership has already indicated that it might be amenable to compromise given that exports constitute the key driver of growth in China and given that the importance of environmental concerns is also becoming self-evident in China itself, in the form of excessive levels of local pollution.

By contrast, the signs from India are that it would take a confrontational stance, taking the issue to an arbitration panel in the WTO.

5. Summary of economic issues

The likely Chinese and EU positions regarding major global economic policy issues can be summarised as follows:

- 1) Trade: China has been a major beneficiary of the rules-based global trading framework (WTO). It is likely to support this system, which it is anyway bound to dominate.
- 2) Climate change: this will be a key area of friction. The EU and China are on opposite sides here, but a compromise is still possible, indeed likely.
- 3) Energy: As China depends less on access to hydrocarbons than others and since it does not have political problems in the Middle East, its interest will be limited.
- 4) Global finance: China does not have a stake in financial market regulation and will resist any attempt to interfere with its exchange rate policy in the context of global surveillance. A greater role in the global financial institutions might be welcome for China, but would only be used to block interference with its own policy (much as the US has done so far).

Washington Tea Parties: Managing Problems and Imagining Solutions in US China Policy

Brantly Womack¹

There are two American tea party traditions, both relevant to American attitudes towards the rise of China. The first is English-style polite; playing by the rules. Applied to China policy, its influence can be seen in constructive engagement, encouraging China to be a responsible stakeholder. The second is Boston-style dramatic unilateralism.² The urge to stand tall, to upset the table, is most evident in declarations about US China policy aimed at domestic American audiences. These two contrary trends are evident in their purest form at both ends of the spectrum of attitudes towards China, but the tension between them defines the general ambivalence in America's perspective on the rise of China. Since the end of the Cold War the US has generally played by the rules in managing specific problems in its relations with China, but at the same time there has been a vocal undercurrent wanting to solve the 'China problem' in various ways. Both of these trends are likely to continue for the foreseeable future. Regardless of the call for change reverberating in the current presidential campaign – and the real changes occurring in the global economy – Washington is likely to continue to be influenced by both tea parties for the time being, but with a preference for practical management at the presidential level.

Although the presidential candidates had quite different styles and emphases in their pronouncements regarding China, the tea party tensions were evident in both. Their most extensive and personal statements on China policy can be found in *China Brief*, a publication of the American Chamber of Commerce in Beijing (AmCham-China).³ Since the table is set in China among American businessmen, the venue favours the polite tea party approach. McCain is certainly the more Bostonian of the two. He couches his positive gestures in more general frameworks of relations with Asia and commitments to free trade, while most of his China-specific comments focus on what China needs to do in order to be an acceptable stakeholder: "The next administration should be clear about where China needs to make progress." McCain would like to see more transparency in China's military build-up and more cooperation against 'pariah states.' On the other hand, McCain claims that "China and the United States are not destined to be adversaries," and his opposition to protectionism would restrain the use of economic sanctions.

Obama's essay is more carefully crafted and more comprehensive. It touches on the major points of policy contact between the US and China, and seems designed to be well received not only by American businessmen in China, but by the Chinese themselves. He praises China's economic accomplishments and balances an admonition about sustainable growth with the admission that the United States also must make "serious adjustments." He is optimistic about the direction of relations across the Taiwan Strait and about cooperation on resolving the North Korean nuclear issue. He emphasises, unlike McCain, that Asian security requires the inclusion of China in strategic cooperation. However, Obama also indicates that he is prepared to stand up to unfair trading practices.

¹ Brantly Womack is Professor of Government and Foreign Affairs at the University of Virginia.

² On 16 December 1773, citizens of Boston as the "Sons of Liberty" boarded three East India Company ships and threw 45 tons of Darjeeling tea into Boston harbour as part of a dispute over taxes and control of trade. The event, known as the "Boston Tea Party," was an important precursor to the American Revolution a few years later.

³ John McCain, "US-China Policy Under a McCain Administration", *China Brief*, September 2008 (<http://www.amcham-china.org.cn/amcham/show/whatisnew.php?Id=88>); Barack Obama, "US-China Relations Under an Obama Administration", *China Brief*, September 2008 (<http://www.amcham-china.org.cn/amcham/show/whatisnew.php?Id=89>).

The context of talking to American businessmen already engaged in China is quite different from a town meeting in a union hall in Ohio. Moreover, these pieces are more likely to have been written by the candidates' China specialists than by their Ohio specialists. Both candidates are therefore showing the sunny sides of their China policies. The shadows can be seen in their silences. McCain does not mention Taiwan. Anything he would say would risk alienating either his present audience or his more right-wing and defence industry supporters back home. Moreover, his emphasis on America's allies in Asia and his complaint about Chinese military opacity could fit into a Rumsfeld-Cheney view of China as the looming strategic threat. For Obama's part, his brief and mild mention of human rights as an issue in US-China relations is certainly a far cry from Bill Clinton's declamations against the "butchers of Beijing." It is either an indication of a difference with anti-China crusaders such as Speaker of the House Nancy Pelosi or its brevity is merely a prudent silence in front of a business audience. Moreover, he does not detail his advocacy of a value-based international trade system to an audience that includes critics of China's new labour law.

In general, it is impressive that neither presidential candidate used China as a scapegoat for the current economic crisis, preached a crusade against Chinese communism, or called America to arms against the China threat. I would agree with the overall assessment by Professor Shen Dingli of Fudan University that the lack of heat in China issues in the current campaign is a sign that "Sino-US relations are stabilizing."⁴ Of course, each of the China-hostile options remains open to a new president, regardless of campaign rhetoric. But China-bashing would be more useful as a tool of campaign rhetoric than as a basis for policy, so the restraint of both candidates is significant. Nevertheless, differences of national interests remain, as well as the domestic political appeal of future Boston tea parties.

The underlying difficulty of American ambivalence towards China is that polite problem management involves at least a formal acceptance of the legitimacy of the other side as well as the possibility that one might have to settle for less than one's maximum demands. Moreover, exceptionalism is not allowed. Everyone plays by the same rules and everyone must wait their turn.

For China, newly allowed a seat at the global table, playing by the rules is a sign of status. But for the US, the sole superpower, letting China into the game appears as a necessary condescension, especially since China is an unfamiliar newcomer, and a communist one to boot. Even the official terminology of engagement – encouraging China to become 'a responsible stakeholder' and to be 'socialised' into the international system – implies a status difference rather than mutual respect. It is not the rules per se that chafe, since the US wrote them, but rather the necessity of the game. And with China's rise to global presence in the new century the games appear both more necessary and more frustrating.

To a great extent the two tea parties express the tension between the necessity of managing the relationship with China and the lingering impulse to 'solve' the China problem. Since the task of managing the relationship falls to the American president, even China problem-solvers like Ronald Reagan and Bill Clinton moved towards more accommodating diplomacy once they were elected. The presidential learning process has now filtered down to the level of presidential candidates, but there are still many public voices, including congressional ones, that want to dump the tea in the harbour (this time Chinese tea) and consider any compromise or even delay as a sign of official cowardice.⁵ The premise of the latter-day Bostonians is that if only bold moves were taken, the China problem could be solved, a premise known to be false by those in charge of managing the relationship. Nevertheless, the calls from the sidelines to stand tall against China exert pressure on presidential rhetoric and on policy options.

⁴ Shen Dingli, "Beijing's Perspective: Sino-U.S. Relations and the 2008 Presidential Election", *China Brief* (Jamestown Foundation), 8, p. 18, 23 September 2008 (http://www.jamestown.org/terrorism/news/uploads/cb_008_018.pdf).

⁵ See for example "Testimony of Sophie Richardson [Human Rights Watch] before the Congressional-Executive Commission on China", 27 February 2008.

The global economic crisis currently unfolding will add to the tensions between managing the US-China relationship and calling for solutions. Although the crisis will have negative effects on both countries, the US and China face the crisis from vastly different perspectives. For the US, the International Monetary Fund estimates a GDP growth rate of one-tenth of 1% for 2009, and it admits that this is the optimistic edge of its range.⁶ Cassandra speaks more gently to China, predicting a fall from its 2007 growth rate of 11.9% to 9.3% in 2009.⁷ Although the predicted gap in growth rates is actually smaller in 2009 than it was in 2007, the psychological effect of an American economy stagnant at best and a Chinese economy still galloping forward will be immense.

It is almost inevitable that there will be a temptation to scapegoat China as the cause of the crisis, and to see solving the China problem as the solution to America's economic problems. China will certainly be the most inviting target for protectionist sentiments, and any concrete step that China could take will elicit from many on the sidelines the response, "Not enough!" More subtly, it is imaginable that companies and institutions with interests in military budgets for high-tech weaponry will feel doubly threatened by an economic crisis and an Obama presidency, and will therefore exaggerate the 'China threat' in order to profit from being the solution.⁸

Nevertheless, the actual magnitude and complexity of the global economic crisis are almost certain to keep the management of the US-China relationship within the bounds of mutual interest. As Henry Paulson's recent article in *Foreign Affairs* suggests, cooperation and mutual understanding between the US and China will be essential to coping with both the immediate problems caused by the collapse of institutions and expectations and the longer term problems of global economic restructuring.⁹ China's foreign reserves, its growth rate, and its centrality to Asia combine to make it a reality that cannot be imagined away. China is too important as part of the possible way out of global economic uncertainty to be dismissed as a problem.

There will of course be hard bargaining on economic issues. In 2009 no US president will be able to afford a trade and investment policy that ignores the problem of jobs at home and trade deficits. Pressures for greater protection of intellectual property and for raising the exchange rate of the renminbi (RMB) will continue regardless of China's actual accomplishments in these areas. There will be pressure for greater quality control of exports. An Obama administration is likely to emphasise environmental and labour concerns in its trade policy. These matters are not simple contradictions between national interests, however. China has already overhauled its labour law and the milk crisis has created a firestorm of popular demand for product quality control. There would be major domestic beneficiaries both to greater IP protection and to raising the exchange rate. Since the issues are not zero-sum, it should be possible to negotiate compromises.

In my opinion, the greatest danger of Bostonian disruption of the US-China relationship would come from diverging reactions to third country events rather than from an economic crisis. Although accidents in bilateral relations can never be ruled out – prime examples are the bombing of the 1999 Chinese embassy in Belgrade and the 2001 spy plane incident – these typically lead to incident-focused, temporary crises. By contrast, continued American unilateral adventurism could lead to standoffs in which China and the US could assume increasingly adversarial positions. By temperament and by policy record Obama would not be likely to continue the path of the last eight years. The same could not be said of a McCain-Palin administration given his penchant for 'zingers', out-of-the-box quick fixes and her moral primitivism. Intervention in Iran or North Korea would confirm a pattern of behaviour that China would find offensive and implicitly threatening. However, in the context of

⁶ International Monetary Fund, *Global Economic Outlook: October 2008*, Washington, 2008, p. 51.

⁷ *Ibid.*, p. 65.

⁸ See Jim Lobe, "Hawks looking for New and Bigger Enemies?", *Interpress Service News Agency*, 5 May 2008 (<http://ipsnews.net/news.asp?idnews=33143>).

⁹ Henry Paulson, "A Strategic Economic Engagement: Strengthening U.S.-Chinese Ties", *Foreign Affairs*, September/October 2008.

pressing economic problems and existing commitments in Iraq and Afghanistan, further adventures are less likely. A third-country event that is not caused by either the US or China, such as the collapse of the Myanmar government, would expose differences of national perspective but would more likely lead to issues of diplomatic management than confrontation.

The global economic crisis will slow China's rise in absolute terms, but it is likely to increase its growth rate relative to developed economies. China is likely to be the most stable major economy in a world of global economic uncertainty. Moreover, its cautious financial policies and multilateral diplomacy are well-suited to the new environment of uncertainty. China will be a major player in the restructuring of the global economy, and it will become the decisive player in the Asian regional economy. China's international prestige is likely to leap forward.

The United States inevitably has ambiguous feelings about the rise of China. On the one hand, it is a new reality beyond American control and economically it has been a win-win process. We may not be in a Chinese century, but we are certainly in a century with China. On the other hand, it erodes the American sense of self-importance and self-confidence in being the world's only superpower. It is not surprising, therefore, that even as the core momentum of a stable US-China relationship builds, American attitudes will also show a tendency to imagine a solution to the 'China problem' and a return to happier days of unilateralism.

Variants of Russia's Policy towards the Rise of China

Alexei D. Voskressenski¹

Russia and China maintain complex external relations with the rest of the world, notably in their strategies towards Asia, and both aim to exploit the potential of the other to accelerate their national modernisation projects. It is against this background that the political elites of Russia and China strive to construct a strategic partnership.² A number of actors explain China's well-known interest in Russia: Russia's military-technical potential, its power projection capabilities, its independent foreign policy and Russia's resources and raw materials are among the factors at play. These resources supply some of China's production chains, especially in the northern provinces of the country.³ In an international and geopolitical sense Russia has become a key ally to China, helping to resolve global issues and regional questions on the northern and north-western borders of the country, from communication in the UN Security Council to a certain coordination of diplomatic activities in the Near East and Central Asia (including strengthening the joint project: the Shanghai Organization of Cooperation) etc. Russia's economic interest in China is linked to the realisation of China's military-technical and security programmes, which are undergoing forced modernisation but have limits in terms of attracting national and international technologies for military modernisation. There are also opportunities to receive Chinese investments and relatively sophisticated but cheap technology to benefit Russia's regional economy. Some analysts also argue that Chinese labour resources could be of some interest to Russia.

Notwithstanding the intense growth of official parameters in bilateral economic activity and the internationalisation of the economy in the Russian Far East, which is becoming the main focus for Russia's political elite in Russian-Chinese relations, the intense Russian-Chinese trade turnover barely disguises serious problems, both on a regional and federal level of relations. Russian interests demand that its economic relations with foreign, especially neighbouring countries have a stabilising influence on the Russian economy as a whole. They also aim to promote its structural transformation, eliminate economic disparities between the Russian regions, strengthen the expansion of Russian state corporations and private businesses in international markets, increase the economic role of the country internationally and, finally, 'tighten' the territories of the Russian nation-state into a single whole. This reinforcement of the concept of Russian statehood should assume a special role for the regions in national development. This does not occur in reality, however.⁴

Since the end of the 1980s the Chinese authorities have carried out a sophisticated strategy of forced modernisation and rapid development based on importing foreign technologies and equipment and, recently, with an emphasis on strengthening export-oriented production structures in the territories of north-east and north-west China, mechanical engineering and electronic equipment. The realisation of such a strategy has coincided with the economic opening of the Russian Far East, Transbaikalia and

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² Chikahito Harada, *Russia and North-east Asia*, Adelphi Paper No. 310, Oxford: Oxford University Press, 1997, pp. 39-40; Alexei D. Voskressenski, "The Rise of China and Russo-Chinese Relations in the New Global politics of Eastern Asia", in Iwashita Akihiro (ed.), *Eager Eyes Fixed on Eurasia: Russia and its Eastern Edge Vol. 2*, Sapporo, 2007, pp. 3-46.

³ *The Sino-Russian "Strategic Partnership": Current Views from the Border and Beijing*, Sapporo: Slavic Research Center, 2003, pp. 55-75 (<http://www.ino-center.ru/Russia-China/russia-china.pdf>, p. 4).

⁴ See A.D. Voskressenski, "Russia and China: potential, prospects, challenges and problems in regional relations" (in Russian), in *Vzaimodeistvie Rossii i Kitaya v Global'nom Kontekste* (Russian-Chinese Interaction in the Global Context), Vladivostok, 2007, pp. 70-135.

Siberia. It also coincides with the economic crisis in Russia and, accordingly, with the massive imports into Russian regions of foreign goods to offset the consequences of the Russian economic crisis of the 1990s. Chinese strategy was later reformulated to meet domestic demand – unfettered by world market limitations. These phenomena have led to high rates of economic growth for China as a whole and in recent decades also for north-eastern China neighbouring Russia. This recent economic growth far surpasses that of Russia as a whole, especially that of the Russian Far East and Transbaikalia territories. China's success will probably continue well into the 21st century.

A number of factors explain the relative vulnerability of Russia's Far Eastern inter-regional economic development compared to other countries and especially to China: the sparseness of the population in the Russian periphery, the uncertainty of the regional development model, infrastructural backwardness and the length of communication lines between Russian-Chinese trade and economic cooperation. These factors have promoted the resolution of trade and economic problems in north-eastern China, but not in the Russian Far East, though they have led to the increased circulation of imported technologies and products in the Russian Far East and Siberia.

These negative trends in the Russian economic territories, especially in the regions bordering China, have not really been addressed, although a number of measures have been undertaken by the Russian authorities. An analysis of regional economic development shows that despite a dynamic increase in the parameters of Russian-Chinese trade, the Russian Far East is slowly but surely losing economic ties with the rest of the country and lowering its industrial production, with no visible substitution of new spheres of economic development since the late 1990s. The population there continues to decline, the region generally continues to reorient its exports (first of all in terms of resources and raw materials) towards China, and at the same time the Russian Far East is marginalising itself within the system of regional economic relations. Such a situation, in the opinion of Russian experts, could result in further regional imbalance in Russia, especially if accompanied by certain negative events, and would result in the loosening of state control over the far eastern territories. Other Russian experts, on the other hand, consider the prospects of Russian-Chinese political and economic interaction, especially on the world stage, as a counterweight to all the problems arising within the regional relations between Russia and China.

For the most part Chinese analysts believe that in the next 10 years Russia will not be able to wean itself off the model of exporting raw materials and hydrocarbons, and accordingly Russian raw materials will remain the basic staple of Chinese imports for the foreseeable future. However, since Russia has generated impressive economic growth over the last decade, it will need industrial and technical equipment, relatively advanced but not too expensive pharmaceutical products and light industry goods, and consequently will import these goods from China, especially to the Far East and Siberia. From the point of view of Chinese analysts, it is necessary to establish joint Russian-Chinese enterprises in those technological spheres that are underdeveloped or non-existent in China, cooperating in those areas that are above all labour-intensive. This means that Chinese enterprises will pay extra attention to the construction industries, communication and engineering infrastructure markets in Russia, for which Chinese labour resources will be in high demand and will probably be warmly welcomed. Such an analytical vision of regional development only partially corresponds to the desire of the Russian political elite to provide industrial help to the Chinese programme of reviving the old industrial base in the north-east of China.⁵ This programme of possible Russian participation in the industrial modernisation of Manchuria is considered by some factions within Russian political and analytical circles as an important if not core part of the acceleration of social and economic

⁵ Conference papers: "Russian-Chinese regional cooperation: current situation and prospects" (in Russian, Beijing, 5-6 December 2006), "Prospects for the Russian-Chinese relations for the next decade" (in Russian, Beijing, 25-31 March 2007), "Russian-Chinese relations under world and regional views" (in Russian, Moscow, 25-26 May 2007), "Russian-Chinese interaction in the Eastern Asia" (in Russian, Moscow, 10 September 2007), "Russian-Chinese interaction: an experience of institutional and scientific cooperation" (in Russian, Vladivostok, 27-28 September 2007), "Russian-Chinese interaction in the Eastern Asia" (in Russian, Moscow, 10 September 2007), Second Russian-Chinese Forum of Social Sciences, Moscow, 9-10 October 2007.

development of the Russian Far East and Transbaikalia, since it gives these territories a chance to revitalise their industries.⁶

Thus today, the main sticking point in the economic relations between Russia and China and therefore the target of any Russian solution to the further rise of China is the structural imbalance in Russian-Chinese trade and economic relations and the disparity between them and their regional components. The quality and structure of bilateral economic relations, especially its regional dimension, do not match the proclaimed strategic character of relations between the two countries. In order to overcome these negative trends in the Far East and Transbaikalia, the Russian government has elaborated a multitask and multidimensional Federal programme: “Economic and social development of the Far East and Transbaikalia in 1996-2005 and till 2010”. Realisation of this programme provides the alignment of an economic situation in the Russian Far East and Transbaikalia in comparison with other regions of Russia and allows the softening or even elimination of negative factors prevalent today. The question, however, is: what role will be played by Russian-Chinese regional relations in this situation because the direction, character and intensity of the final success of the Russian federal programme “Economic and social development of the Far East and Transbaikalia in 1996-2005 and till 2010” depends on the answer to this. If the Russian authorities manage to formulate the political, legal and economic conditions, incentives and limitations necessary for a Russian-Chinese collaboration that would guarantee steady development, especially in the eastern regions of the country, there would be no need for a special solution to the issue of China rising. In my view this policy should not consist of the forced modernisation model, which only solves short-term problems under certain conditions and has many negative consequences for the economy and the population, but should be a formulation of the system of priorities; the cumulative effects of which can speed up modernisation, limit negative trends and would constitute a policy of state-business partnership.

Russia has four detailed conceptual approaches to the development of Russian-Chinese relations, including Russian-Chinese regional interaction and also the possible solution to the rise of China. The concept of open regionalism has two subvariants: the first relies on investments from the Asian-Pacific region and the regional export of Russian raw materials;⁷ the second relies mostly on Russian federal resources and a more diversified export model.⁸ Despite the administrative resources already generated by these variants, it would seem that they cannot halt negative (for Russia) regional trends, probably because of insufficient coordination or the different views of the situation from the regions and the centre, where there may also be insufficient political support. The world financial crisis does not help in the implementation of these strategies either.

The Russian-Chinese co-development strategy⁹ has also been elaborated in detail and has considerable administrative resources allocated to it. The implementation of this strategy began in 2005, but has not yet led to the alignment of the rates of development, at least not in the Russian and Chinese bordering regions and did nothing to curb negative phenomena for Russia. Co-development as it was conceived would not necessarily mean equally beneficial development, though it could be based on partial, but unequally mutual benefits.

Two other approaches are also analysed in detail here. The multifactor analysis of international/regional relations and security based on energy diplomacy is the pragmatic tool of

⁶ S. Razov, “Russia and China are living through the unique period in their relationships” (in Russian), *Russia-China 21 Century*, September 2007, p. 5.

⁷ S. Darkin, *Russian Pacifica: Strategy, economy, security*, Moscow: Delo Publishers, 2007; P. Minakir, *Economic development and international cooperation in the North-Eastern Asia*, Vladivostok: Dalnauka Publishers, 2001.

⁸ V. Ishaev, “Strategy of the development of the Far East in the changing world” (<http://adm.khv.ru/invest2.nsf/AllNewsRus/ab5e4b18fa714c5cca256d1f0026d9d8>).

⁹ B. Kuzik and M. Titarenko, *Russia and China 2050: Strategy of codevelopment*, Russian Academy of Sciences, 2006.

promoting Russian national interests in Greater Eastern Asia.¹⁰ Such an assessment of a regional azimuth is integrated within the concept of multi-factor equilibrium approach and, as a matter of fact, represents a vision of macro-regional processes within a relatively coherent macro-approach. Applied questions of economic and especially regional economic interaction have not yet been developed on the basis of the concept of multi-factor equilibrium.¹¹ This approach steers the development of Russian-Chinese relations in conformity with the model of more balanced multilateral regional development. One of the most obvious implementation measures within the parameters of this approach is the construction of the Western Siberia–Pacific Ocean pipeline, which is aiming to bring cooperation to the competitive regional energy market and open it to all interested regional participants.

The so-called ‘guardian’ or ‘Russia as a fortress’ concept sees the army and the state safeguarding the development of Russian-Chinese regional relations. This concept is also elaborated in detail,¹² but has no definite administrative support although, apparently, there are some supporters in the state and military structures, especially in the border areas. This approach has been partially implemented in the Far Eastern frontier zone, its strength consisting of the appeal to the historical experience of Russian-Chinese economic interaction where the structuring role from the Russian side was traditionally played by the state and army. This approach also has obvious weak points however, of which the first is the under-assessment of new global trends (regionalism, particularly)¹³ and a reliance, first of all, on primarily non-economic actors and accordingly her *a priori* money and resources consuming character¹⁴ which will inevitably lead to the curtailing of regional economic interaction in the region and the reliance on only federal financial and military power resources. It is quite probable that as a result of the implementation of this concept some kind of semi-power/supramilitary opposition in an economic zone of the Russian-Chinese border-region will arise. This approach would definitely be economically detrimental in these times of economic crisis and stagnation.

What is clear is that in the future, due to the current political power restructuring in Moscow, we can envisage the synthesis of these four approaches as the effective state strategy for the development of the Russian Far Eastern territories within the limits of Russian-Chinese partnership, and the multilateral cooperation in north-east Asia. It is not yet clear however whether the assessment of the four above-mentioned approaches to ensure the steady, balanced, highly competitive, open and mutually advantageous regional development in which Russia will take a worthy place has been elaborated or not.

¹⁰ A. Torkunov (ed.), *Energy dimensions of the international relations and security in the Eastern Asia*, Moscow: MGIMO-University, 2007.

¹¹ Alexei D. Voskressenski, *Russia and China. A Theory of Inter-State Relations*, London: Routledge, 2003.

¹² K. Tatstenko, *Trends in economic interaction between the Russian Far East and the North-West of China*, Vladivostok: Dalnauka Publishers, 2006.

¹³ G. Rozman, *Northeast Asia's Stunted Regionalism. Bilateral Distrust in the Shadow of Globalization*, Cambridge: Cambridge University Press, 2004.

¹⁴ With the exception of certain projects, like the rocket-launching station near Blagoveschensk.

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