

New Model of Major Power Relations: Domestic and Economic Policies

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An Overview

- ◆ Definition of a Major Economic Power
- ◆ Projections of the U.S. and Chinese Economies
- ◆ A New Model of the Economic Relations between Major Powers
- ◆ Potential Areas of Cooperation
- ◆ Cooperation in the Provision of Global Public Goods
- ◆ Concluding Remarks

Definition of a Major Economic Power

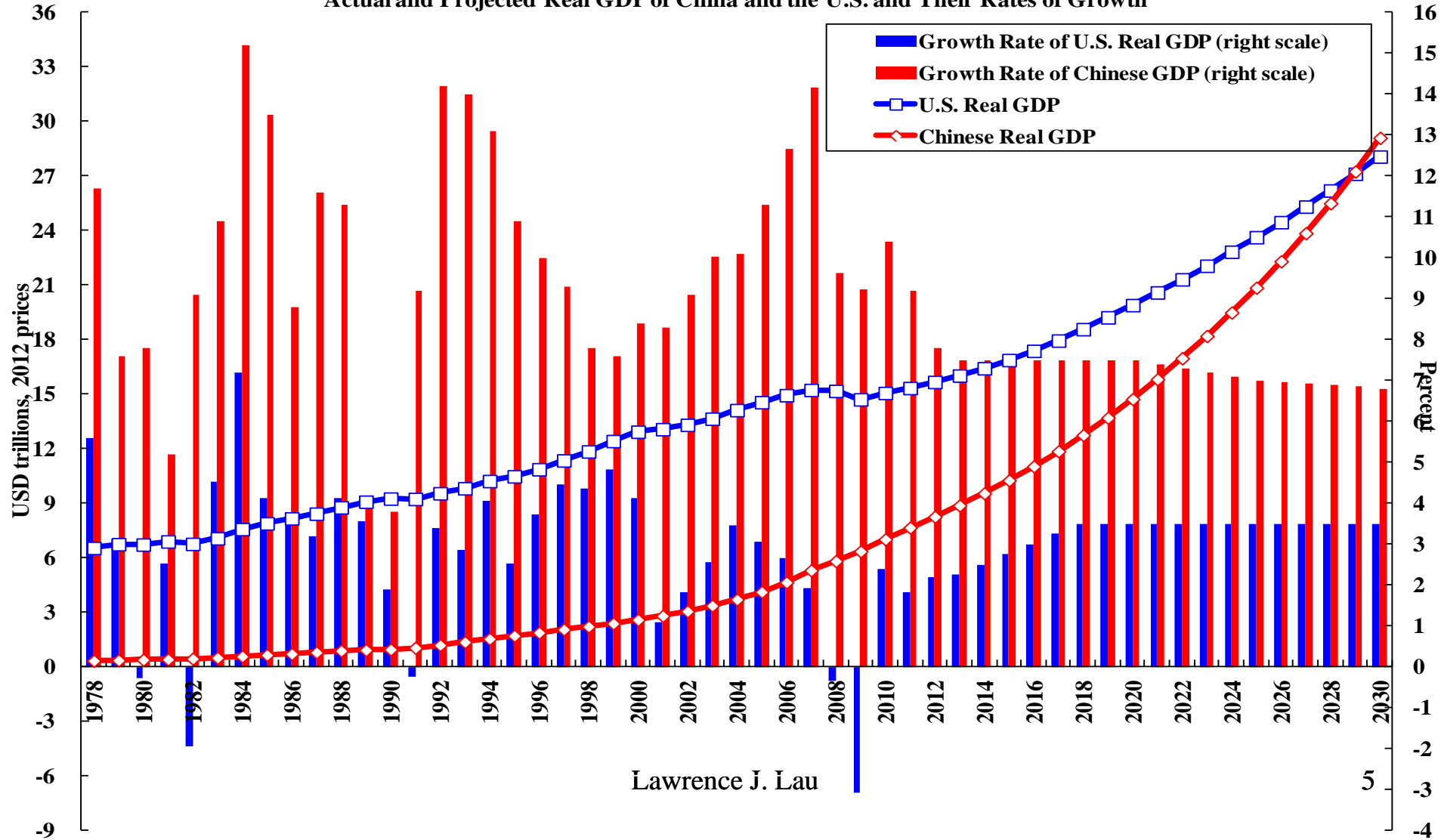
- ◆ A large GDP--the U.S. and China are respectively the largest and second largest economies in the World measured by real GDP
- ◆ Large volume of international trade—the U.S. and China are the two largest trading nations in the World
- ◆ Ability to affect markets through either demand or supply—the U.S. and China through their demands can affect the prices in the energy and natural resource markets
- ◆ Ability to lead the World on economic initiatives—the U.S. as the leading developed economy and China as the leading developing economy can provide leadership to the World economy, especially if they work together for common purposes.

Projections of the U.S. and Chinese Economies

- ◆ Chinese real GDP is projected to catch up to U.S. real GDP in approximately 15 years' time--around 2028, at which time both Chinese and U.S. real GDP will exceed US\$28 trillion (in 2012 prices), almost three times the current Chinese GDP and not quite two times the current U.S. GDP. (Bear in mind that in the meantime, the U.S. economy will also continue to grow, albeit at rates lower than those of the Chinese economy.)
- ◆ By this time, China and the U.S. will each account for approximately 15% of World GDP.

Actual and Projected Chinese and U.S. Real GDPs and Their Rates of Growth

Actual and Projected Real GDP of China and the U.S. and Their Rates of Growth

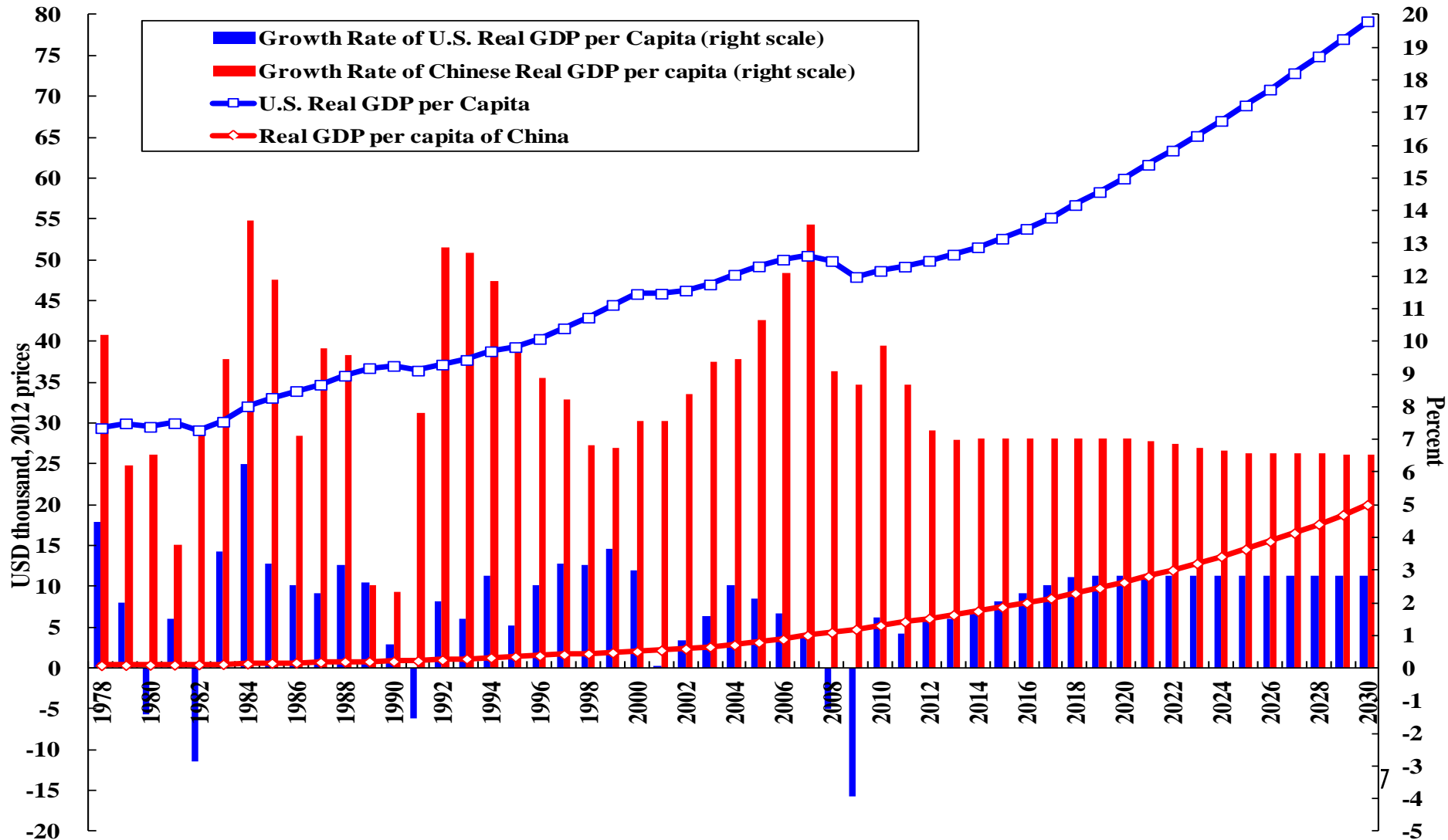


Projections of the U.S. and Chinese Economies

- ◆ By 2030, Chinese real GDP per capita is projected to exceed US\$19,500, which will still only be slightly more than a quarter of the projected then US per capita real GDP of US\$77,600.
- ◆ It will take 45 years for Chinese real GDP per capita to catch up to US real GDP per capita, some time before 2060.

Actual and Projected Chinese and U.S. Real GDP per Capita's & Rates of Growth

Actual and Projected Real GDP per Capita of China and the U.S. and Their Rates of Growth

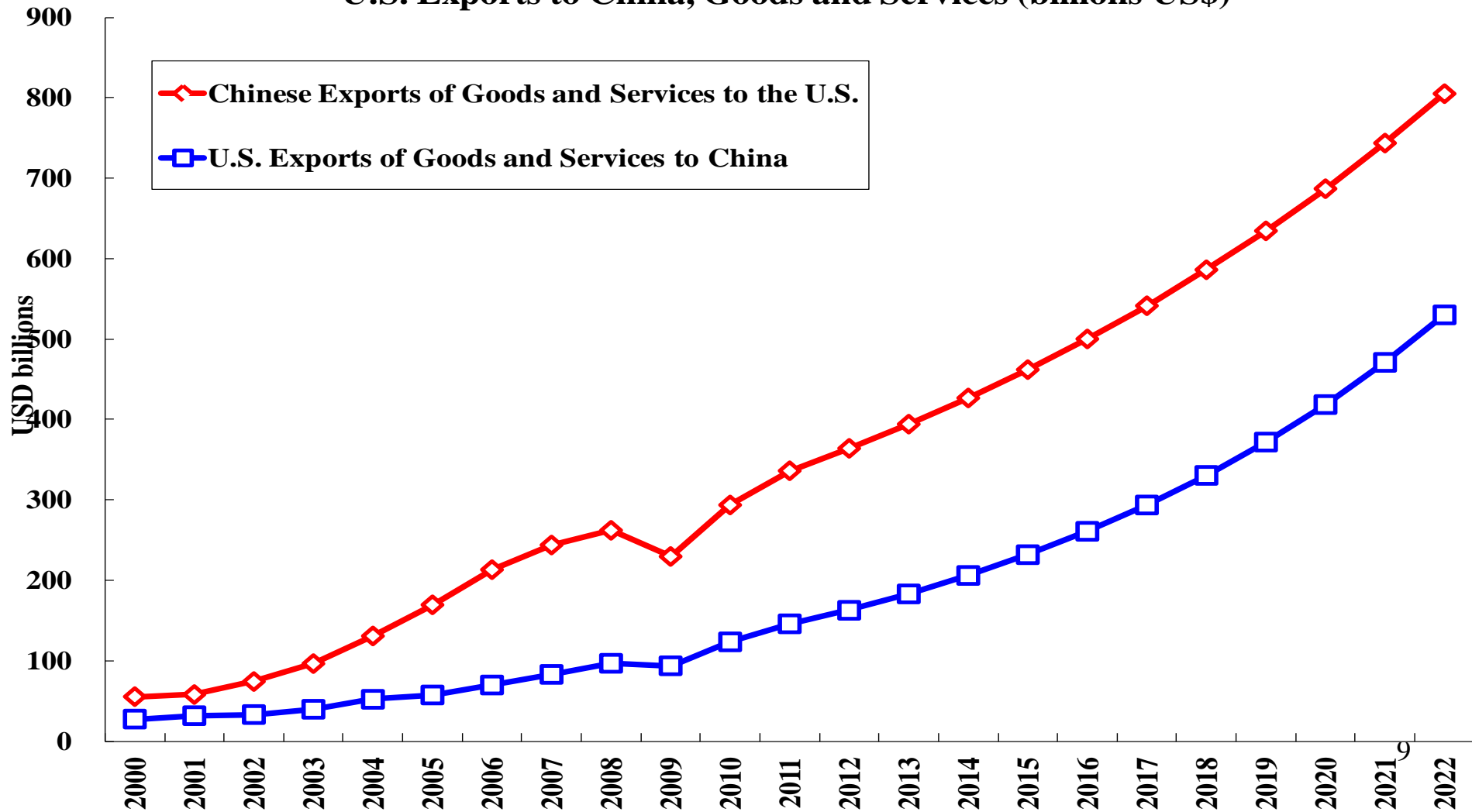


Projections of U.S.-China Bilateral Trade

- ◆ By 2022, the U.S. and China are likely to be each other's largest trading partner in the world.
- ◆ U.S. exports to China are projected to rise to US\$530 billion, more than three times the current value.
- ◆ By 2022, Chinese exports to the U.S. are projected to reach US\$805 billion.
- ◆ Despite the higher rates of growth of U.S. exports of goods and services to China since 2007, China's trade surplus with the U.S. is likely to remain high in 2022 at US\$275 billion but would only be 1.5% of its GDP.
- ◆ It is expected that China will run a trade deficit with the rest of the World.

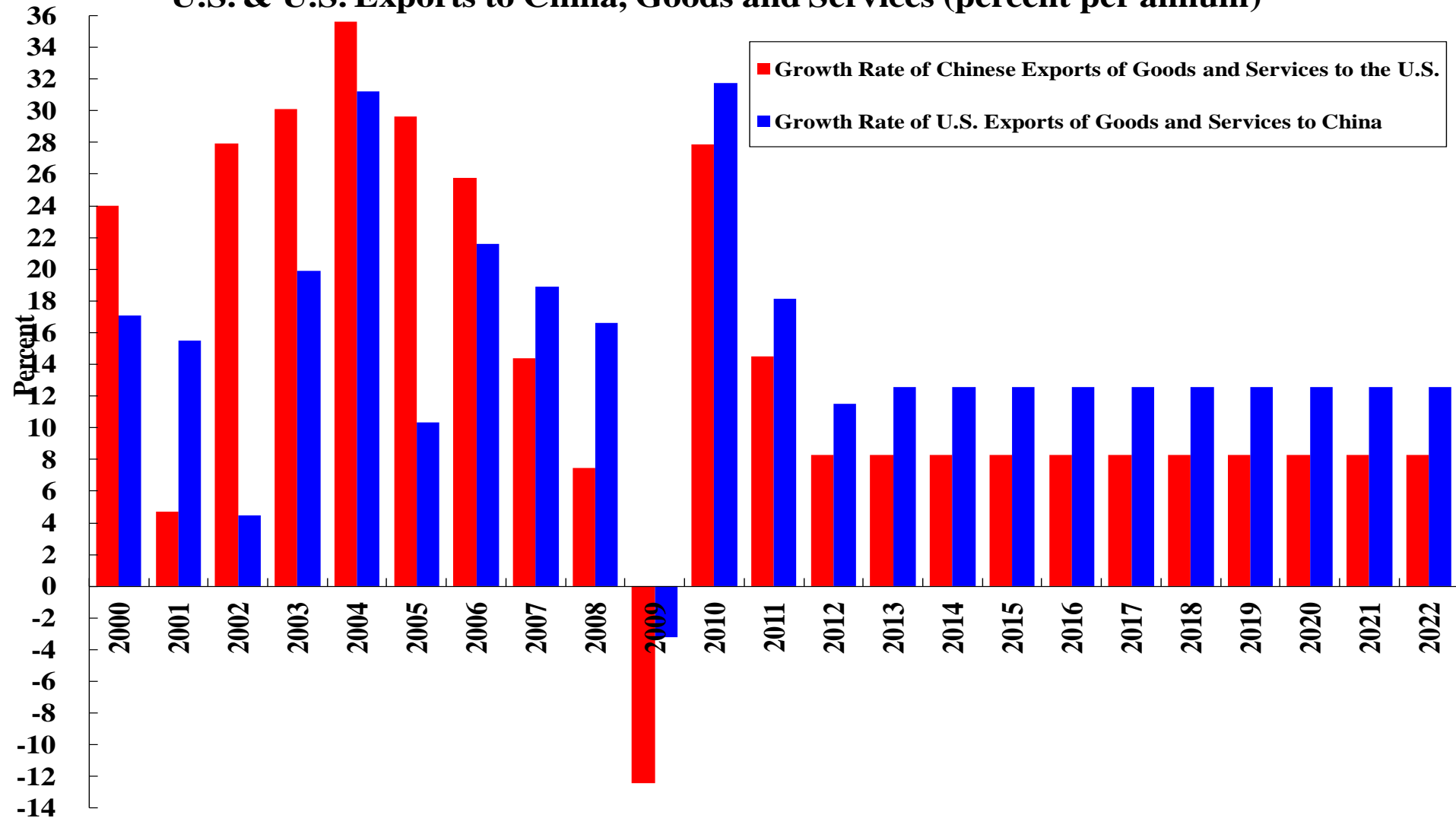
Actual and Projected U.S.-China Bilateral Trade (projections based on 2012 prices)

Chart 9: Actual & Projected Chinese Exports to the U.S. & U.S. Exports to China, Goods and Services (billions US\$)



Actual and Projected Rates of Growth of U.S.-China Bilateral Trade (2012 prices)

Chart 10: Actual & Projected Rates of Growth of Chinese Exports to the U.S. & U.S. Exports to China, Goods and Services (percent per annum)



Projections of U.S.-China Bilateral Trade

- ◆ It is possible that U.S. exports to China can be much higher if one or more of the following conditions are realized:
- ◆ (1) U.S. approves the export of liquefied natural gas (LNG) to China (U.S. has the potential of becoming a major exporter within the next decade);
- ◆ (2) U.S. and Chinese enterprises enter into long-term contracts for large-scale exports of agricultural commodities—for example, corn, soybean, beef, chicken and pork—from the U.S. to China;
- ◆ (3) U.S. control on high-technology exports is relaxed.

A New Model of the Economic Relations between Major Powers

- ◆ Reciprocity: Treating the Other as One Would Like to be Treated
- ◆ Seek Win-Win Solutions
- ◆ Mutual Recognition of Core Interests
- ◆ Acknowledgment of Possible Differences in Interests— Agreeing to Disagree
- ◆ Taking into Account the Effects of One's Actions on the Other
- ◆ Coordination
- ◆ Full Information on Both Sides (Understanding Each Other's Domestic Constraints and Communication of Contingency Plans—No Miscalculations and No Surprises)
- ◆ Cooperation and Coordination on Global Issues

Potential Areas of Cooperation:

Trade

- ◆ The U.S. and China should conduct feasibility studies and begin early stage discussions of the opportunities and challenges of an eventual bilateral Free Trade Agreement between them.
- ◆ The U.S. and China should develop mechanisms for speedily resolving trade disputes and to avoid bundling.

Impacts on U.S. and Chinese Employment and GDP

- ◆ For every US\$1 billion of U.S. exports to China, an estimated value-added of US\$0.86 billion and employment of 4,800 person-years are created in the U.S.
- ◆ In 2022, U.S. exports to China of US\$530 billion are projected to generate US\$456 billion worth of value-added (up from US\$100.8 billion in 2010), or 2.2% of the then U.S. GDP, and more than 2.54 million jobs (up from 732,800 in 2010) in the U.S.

Impacts on U.S. and Chinese Employment and GDP

- ◆ For every US\$1 billion of Chinese exports of goods and services to the U.S., an estimated value-added (GDP) of US\$0.641 billion (up from 0.573 billion) and employment of 15,000 (down from 38,930 in 2012) person-years are created in China.
- ◆ In 2022, an estimated value-added of US\$516 billion, or 3% of the then Chinese GDP, and total employment of 12.08 million person-years are generated by Chinese exports to the U.S.
- ◆ These are all very significant numbers and they indicate a high degree of potential economic interdependence.

Potential Areas of Cooperation:

Investment

- ◆ An important aspect of the economic complementarity between the U.S. and China is the huge difference in the saving rates. The U.S. gross saving rate is about 12%, whereas the Chinese saving rate approaches 50%. China both saves too much and invests too much and the U.S. saves too little.
- ◆ Both economies can benefit if Chinese nationals (individual and firms) can increase their direct and portfolio investment in the U.S.
- ◆ The U.S. and China should conclude a bilateral investment treaty so as to facilitate two-way direct and portfolio investment flows between the countries.

Potential Areas of Cooperation:

Investment

- ◆ The stock of U.S. direct investment in China in 2011 was US\$54 billion according to the U.S. and US\$70 billion according to China, compared to the stock of Chinese direct investment in the U.S. of not quite US\$10 billion.
- ◆ U.S. direct investment in China has been quite successful, generating almost US\$40 billion of annual profits and also creating 1.8 million jobs in China.
- ◆ China's service sector is relatively immature, while the U.S. has the most sophisticated service sector in the world. China needs to expand its service sector to provide employment opportunities for its people. U.S. firms can help China develop its service sector through exports to and direct investments in China.

Potential Areas of Cooperation:

Investment

- ◆ Moreover, the prospects of U.S. direct investment in China are excellent. General Motors is already the market leader in the Chinese automobile market; Wal-Mart is China's largest retailer; and McDonald's and KFC are already household names. The potential for these and other U.S. businesses yet to invest directly in China is enormous.
- ◆ Chinese direct investment in the U.S. can create new jobs and GDP in the U.S., especially if the investment is in greenfield projects.

Potential Areas of Cooperation:

Agriculture

- ◆ Among the major concerns of China and its people are food security and food safety. Is there enough food to feed everyone? Is the food safe and hygienic?
- ◆ The U.S. has the most sophisticated agricultural technology as well as systems to ensure food safety. The abundance of arable land and irrigation water in the U.S. and the high productivity and efficiency of U.S. agriculture mean that the U.S. has the capability to further increase its agricultural production and exports to China significantly and thus help China ensure its food security as well as food safety at the same time. China does not have sufficient land or water. Both countries can benefit greatly through such cooperation.
- ◆ The key to increased trade in agriculture is a credible assurance of long-term supply by the U.S. and long-term demand by China.

Potential Areas of Cooperation:

Tourism

- ◆ In 2012, about 1.5 million Chinese tourists visited the U.S. This number is projected to exceed five million a year by 2022 if visa administration is further streamlined and to reach 10 million if visa requirement can be waived altogether. A million Chinese tourists a year is estimated to generate a value-added of US\$3.5 billion and 61,352 jobs, so that potentially up to US\$35 billion of GDP and 0.6 million jobs can be created through tourism by 2022.
- ◆ It is possible to facilitate visits in both directions by introducing online visa applications by the citizens of both countries. The visa applications can either be approved directly or the applicants can be asked to submit hard-copy applications for further consideration. Increases of mutual visits by the citizens of both countries can only improve relations between the two peoples.

Potential Areas of Cooperation:

Energy

- ◆ China today relies overwhelmingly on coal as a source of energy (approximately 70%), which pollutes the atmosphere as well as emits excess greenhouse gases. China has large deposits of shale oil and gas. The investment and technological cooperation of U.S. firms in China's nascent shale oil and gas industry can help China reduce its dependence on coal as a source of energy. This benefits not only the U.S. and China but also reduces significantly Chinese carbon emissions and hence the risks of global climate change.
- ◆ There is still a great deal of room for the improvement of energy efficiency in China at the industry level. This presents opportunities for U.S. technology and U.S. firms.

Potential Areas of Cooperation: Intellectual Property Protection

- ◆ Intellectual property protection is a critical issue not only for the U.S. but also for China as well. China is in the process of trying to transform its economy from an input-driven one to an innovation-driven one. It will therefore have an interest in promoting innovation within China. Protection of intellectual property rights is essential. An outstanding example of such a transformation is that of Taiwan, from being the piracy capital of the World to a thriving center of innovation (more than 10,000 U.S. patents granted to Taiwan inventors last year).
- ◆ In the China-U.S. Exchange Foundation report, the establishment of a national intellectual property court in China which will have jurisdiction over all intellectual property disputes in all of China has been proposed.

Potential Areas of Cooperation:

Exchange Rate Coordination

- ◆ A relatively stable US\$-Renminbi exchange rate is not only good both trade and investment flows between the two countries but also provides the foundation for stability of the other exchange rates in East Asia and the World.
- ◆ A proposal by Prof. Robert Mundell, Nobel Laureate in Economic Sciences: Both sides agree on a range, say, between 5.5 and 6.5 Yuan per US\$, but with the responsibility for intervention divided between the two sides on an incentive-compatible way. If the U.S. side finds the Renminbi too weak, say, near the 6.5 Yuan mark, the U.S. can buy Renminbi in the foreign exchange market with US\$ to drive it up; if the Chinese side finds the US\$ too weak, say at the 5.5 Yuan mark, it can buy US\$ in the foreign exchange market to prevent it from becoming too weak. Over time, if this arrangement works, the range can be gradually narrowed.
- ◆ If the US\$-Renminbi exchange rate is relatively stable, it can₂₃ in time form the basis of an effective global currency.

Cooperation in the Provision of Global Public Goods

- ◆ The U.S. and China, as the two largest energy producing as well as consuming countries in the World, can cooperate to improve energy efficiency, assure energy security and promote research on renewable sources of energy.
- ◆ The U.S. and China, as the two largest emitters of greenhouse gases, should take common responsibility for the reduction of the risks of climate change and cooperate to forge a global consensus in the forthcoming negotiations relating to the control of global emissions. There is a window of opportunity as the increased supply of gas in the U.S. (from for example shale) reduces the cost of reduction of carbon emission in the U.S.
- ◆ The U.S. and China, as the two largest trading countries in the world, should also take the lead in re-invigorating the Doha Round of world trade negotiations and enhancing the multilateral trading system, benefiting not just themselves but also the entire World economy.
- ◆ The U.S. and China, working together, can also overhaul the international monetary order to make it much more stable and secure.

Concluding Remarks

- ◆ Closer economic cooperation between the U.S. and China can bring significant benefits not only to themselves but also to the rest of the World.
- ◆ In addition, it will enhance mutual economic interdependence which can in turn reduce the mistrust and strengthen and sustain the overall relationship between the two countries.