JOHN GONG

# Chinese Investment and American Infrastructure Under the New Sino-U.S. Relations

*These are the remarks of Dr. John Gong to the Schiller Institute conference in Morristown, N.J. on Feb. 16, 2019. Dr. Gong is Professor of Economics at the University of International Business & Economics in Beijing, China. This is the speech as delivered, combined with material from his written text that Dr. Gong omitted because of time constraints. Subheads have been added.*


EIRNS/Stuart Lewis

*Dr. John Gong*

Dear Mrs. LaRouche, leaders of the Schiller Institute, ladies and gentlemen. It is a great honor to be invited to the Schiller Institute's conference in Morristown, New Jersey. It's a beautiful North Jersey town that I am so familiar with. Not far from this hotel is the Morristown Green. Take the second exit onto South Street, drive for less than two miles to arrive at 445 South Street. That is the complex where I used to go every weekday for seven years, until 2001, when I was a research scientist at the Applied Research Lab at Bell Communications Research. Today I am in China, teaching economics at the University of International Business and Economics. In a way, my personal experiences, both in the United States and in China, testify to the extent to which our two great nations are interconnected and our two great economies are intertwined.

## The State of Sino-U.S. Relations

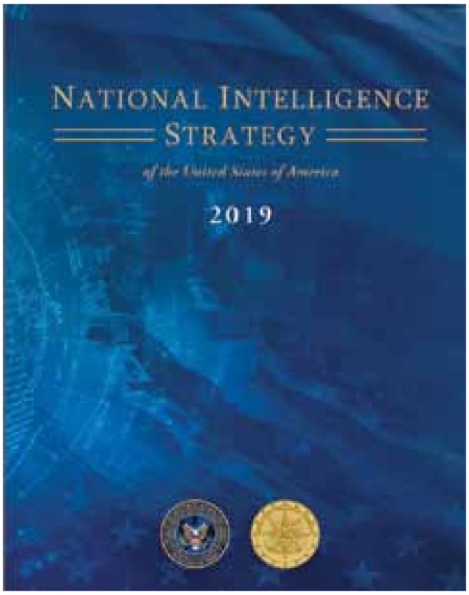
I want to start off by giving you an assessment of the current status of Sino-U.S. relations. First, as we all know, we are unfortunately engaged in a trade war. Official tariffs were first slapped on $45 billion worth of Chinese exports on July 6, two days after America's Independence Day. Rounds of additional tariffs ensued from both sides, until the two Presidents met at the G20 summit in Argentina on December 1, 2018, where a truce was reached so as to leave some more time for further negotiations. China committed to buy several billion dollars' worth of American agricultural and energy products, including some immediately, while the U.S. side promised to postpone for 90 days raising tariff rate from 10% to 25%, which will expire on March 1, this year.

Three rounds of negotiations have taken place so far in Washington, D.C. and in Beijing. Just yesterday a round of talks was concluded with the American delegation led by U.S. Trade Representative Robert Lighthizer and Treasury Secretary Steven Mnuchin, who were also well received by President Xi, which is a very good sign. According to President Trump, this round of talks went extremely well. I am less concerned about the prospect of reaching a trade deal here.

As the largest trading nation and the second largest economy, China cannot afford to go back to an old world severed from the global system of trade and capital investment. On the American side, although there are people close to the President who view these destructive tariffs as, indeed, the ultimate means intended for a total decoupling strategy, I believe that at least President Trump thinks differently and he needs to close what he describes as the largest trade deal ever in history, according to the published transcript of a private telephone conversation with Bob Woodward in the *Washington Post*, before Woodward's book, *Fear: Trump in the White House*, came out. After three rounds of ministerial level talks, there will still be some thorny issues left to be haggled over personally by Presidents Trump and Xi, such that both sides can somehow declare victory.

It may happen before March 1, the deadline, or it may be a few weeks after. That doesn't matter. That's not a big deal.

I am more concerned about overall Sino-U.S. relations. Aside from the prospect of reaching an historic trade deal, the relationship is facing long-term difficulties that impose great constraint on our further economic relations. On the surface, our dispute appears to be about America's trade deficit with China, which reached $375 billion in 2017, according to U.S. statistics, but lying at the heart of the matter, as we all know it, is America's concern for the rise of China's comprehensive national power, including economic power—soft power in the Chinese vocabulary, sharp power in American vocabulary, or whatever definition of power scholars come up with. And I venture to take a step further in stating that the heart of the heart of the matter is Washington's concern for losing its technology edge to China, and perhaps more importantly, what America perceives as the reasons behind this trend.



*2019 National Intelligence Strategy report issued by Dan Coats, Director of National Intelligence.*

## The American Narrative

The American narrative, which is in wide consensus across aisles in Congress, is that China is able to progress quickly mostly because of the notion of state-steered capitalism, for things like industrial policy, state subsidies, support of state-owned enterprises [SOEs], and other contentious structural issues. About technology and innovation, China advances mostly because of IPR theft and coercion. Although all these issues are of concern to Washington, by far the most important issue is with respect to technology and innovation. In that regard, keeping a technology edge is vital for maintaining good American jobs and its defense supremacy.

Fair enough. I think it is indeed a legitimate demand that respect for IPR, that is Intellectual Property Rights, should constitute an indispensable component of fair and just global competition, both among companies and among nations. Matt Pottinger, Senior Director for Asian Affairs at the National Security Council, famously said about the competition between China and the U.S., "In the United States, competition is not a four-letter word."

## The Reality

But I am not sure a nation can climb up the technology ladder by just theft and coercion. I have visited dozens of companies in China, which have never gone through technology transfers of any kind, but are now thriving on global markets. For example, Sany Heavy Industry's Chief Technical Officer (CTO) told me that Sany has been indigenous from day one, and that innovation, on its own, has always been in the company's genes. But notwithstanding whether all of these IPR-related accusations are true or not, let's talk about ways to address these issues so that the two great nations can avoid a kind of Thucydides Trap, such that we have tragically seen in history.

Today America labels China as a competitor, a rival, an adversary. It hasn't been elevated to enemy status yet. Let me quote one paragraph in the latest 2019 National Intelligence Strategy report issued by Dan Coats, the current Director of National Intelligence, who leads the intelligence community of 16 federal agencies:

> Chinese military modernization and continued pursuit of economic and territorial predominance in the Pacific region and beyond, remain a concern, though opportunities exist to work with Beijing on issues of mutual concern, such as North Korean aggression and continued pursuit of nuclear and ballistic missile technology. . . .

That those statements put our relations still on a hopeful footing. The paragraph about Russia doesn't have that though.

The prospect of China taking over the U.S. as the largest economy, and the accompanying comprehensive power, scares a lot of people in Washington. But allow me, as an economist, to question the validity underlying America's concern for China's rise. In economics there is this convergence theory, postulating that growth rates for advanced economies will eventually converge, and that the size of an economy is essentially driven by population. Currently, China is still growing faster than the United States, which is a bit over 6%, about 2% more than the U.S. growth rate. But I don't see the days of over 6% growth rate in China lasting very long. We are going to quickly enter the 5% growth rate territory.

The trend in population is even more revealing. China is most likely to decline in population, while the U.S. is absolutely rising. By 2050, the U.S. population, with a higher birth rate and aided by immigration, is likely to increase to close to 500 million people, while China's population is likely to decline to near one billion people. So, over a long period of time, if we are patient enough, and forward-looking enough, I am not even convinced that China is going to take over the U.S. in any significant way. What I see is a picture of convergence in terms of economic power in light of the economic and demographic trends in both countries. What I see, at most, is a bipolar world, if we will ever reach there, in which China and the United States will probably be comparable in most aspects of power metrics. And to be honest, believe me—even this scenario is many, many years away.

## Some History

The second American concern is with respect to the issue of the China development model in competition with America's cherished free-market model. That is of course the issue of the "Beijing Consensus" versus the "Washington Consensus." China has its own constraint in interactions with the world due to its unique political and economic system. But I don't believe that Beijing intends to promote its model worldwide as it did in exporting revolution in the 1970s, which as we all know turned out to be a total fiasco. China learned that lesson and it won't export ideology anymore.

I may further draw historic inspirations to instill some more confidence in this view. Chinese history is indisputably more of a history of a victim of aggression than aggression. Even during the time when the Chinese fleet ruled supreme on the high seas, we never had a wicked design toward the land our ships reached.

In China's Ming Dynasty, within 30 years starting from 1405, a royal court official, Zheng He, led seven maritime voyages across the Southeast Asia region, through the Strait of Malacca into the Indian Ocean, and sailed as far as the Kenya coastal areas of Africa. This is 87 years earlier than Christopher Columbus's historic voyage to the Caribbean. While Columbus sailed with three ships, Zheng He's fleet consisted of 317 ships with about 28,000 crewmen altogether. We did not colonize places we reached—with sugar and coffee plantations based on African slavery—even though our ships were at least four times larger than those of Christopher Columbus. The size of our fleet was a hundred times larger than that of Christopher Columbus, and our voyage was taken 87 years earlier than Christopher Columbus. And yes, we reached Africa too.

So, the regime in Beijing is not interested in competing with America globally on spread of ideology. And I want to take a step further, by postulating audaciously that the ideological differences embedded in the Beijing Consensus and Washington Consensus are grossly exaggerated, and definitely smaller than many scholars believe. The China development model, as first heralded by Mr. Deng Xiaoping, is flexible, adaptive, and largely deemphasizes ideological penchants in the first place. In fact, some even go so far as to claim that the China development model is essentially having no model.

My own conclusion is that the China development model mostly encompasses the following five aspects: the role of the state which entails industrial policy and the state-owned enterprises phenomenon; the foreign direct investment and exports duo—which is a very successful recipe; a priority placed on economic development at all costs; institutions for efficient but not necessarily liberal governance; and finally, a flexible, incremental and experimental approach to introducing reforms.

## China's Development Model

So, if one compares the above aspects of the China development model with American ideological core values, there are actually more things in common than differences. For example, take sociologist Robin Williams' analysis of American ideological core values as an example. He lists the following: freedom, individualism, idealizing what is practical, volunteerism, mobility, patriotism, progress, and the American dream. The way I see it, the only thing that is fundamentally difficult to reconcile is mostly with respect to the notion of freedom. Both countries have different notions of freedom, I guess.

So, if I am successful in convincing you, the Sino-

U.S. relationship is devoid of ideological competition, and what is left of the American concern must then be in areas of geopolitics, driven by *Realpolitik*. And the very foundation of that, in essence, is an economic competition story. But a quick review of history highlights the fact that America's and China's economies are fundamentally intertwined, and fundamentally complementary toward each other, in nature. The north Pacific trading network, also involving Japan and South Korea, forms the world's largest global value chain. China's economic success is partially a story of success of corporate China's participation in this America-led global value chain.


Wikimedia Commons

*Yearly Pacific Ocean trade flow is valued at $800 billion.*

In addition, corporate America's operations in China represent approximately a $400 billion commercial interest. About 40% of China's exports are associated with foreign multinationals operating in China. The majority of the top-twenty list of the largest exporters in China are either OEMs [original equipment manufacturers] of corporate America or corporate America itself. The Chinese and American economies are complementary because of natural and human resource endowments respectively. America's agricultural and energy products are highly competitive in global markets, and so are its high-tech sectors. China's efficient manufacturing contributes to the low prices at Walmart and Amazon.com.

Adding goods and services together, the trade flow across the Pacific represents close to $800 billion of commercial interest—and that's a lot of money. Only 18 economies in the world have a GDP size greater than that. And this tremendous $800 billion commercial interest is the fundamental bedrock of a peaceful relationship between our two countries.

Against that backdrop, today's China-U.S. relations face a Thucydides trap that is different from historical examples due to these very intertwining and complementary economic attributes. That doesn't mean it does not have its fair share of problems and frictions. But, fundamentally, this is a different type of Thucydides trap than history has ever seen. I call it the "economic Thucydides trap," as most of the areas of true contention manifest in economic relations between the two, which could be partially addressed jointly by three sides. China and U.S., situated an ocean apart, do not have deep national security conflicts, barring the Taiwan issue. Even Taiwan's strategic importance to the U.S. has been waning over time, as modern military technology is running less relevant.

As I've been arguing all along, potential frictions and conflicts are more likely to be rooted in a unique economic Thucydides trap. The possibility of escaping this trap exists, as does the hope of a peaceful and harmonious coexistence between corporate China and corporate America. And the answer is very simple: The planet is a large enough place to accommodate two giants at the same time, as long as each side is recognizant and considerate of the other side's needs and interests. Corporate China and corporate America can cooperate while competing. In some instances, one or more should align them together to seek joint interests in global markets.

In the automobile industry, the success of the Renault-Nissan lines testifies to the viability of such a broad cross-border cooperation. Why can't this model not be tried here, as well, in China? Some may question this model from an ideological perspective in pointing out the mass dominance of China's SOE behemoths in certain sectors. But one only needs to look at the cooperative relationship between General Motors and Shanghai Automotive Industry Corporation [SAIC], which is an SOE in China. They have a successful joint venture based in Shanghai going back decades. Today GM sells more cars in China than in the U.S. During the 2008 financial crisis, SAIC extended a helping hand to help GM weather through its hard time. Today the two

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*America takes pride in its Boeing airplanes, while China prides itself on its high speed railways. Shown here is Boeing's Everett, Washington facility, and a China Railways CRH2E "Harmony" high speed train arriving at Beijing's West Railway Station.*

companies cooperate extensively on global markets, even in areas of R&D and innovation.

Such a close relationship in my opinion should evolve to potential levels that it jointly becomes one. Is this wonderful hypothetical company an American company? Or is it a Chinese company? It doesn't matter. I would call it a global company, in the age of globalization.

### Industrial Policy in China & the U.S.

China could also benefit from being selective in its industrial policy objectives. Industrial policy is controversial in the academic community. But one has to concede that America has its own fair share of industrial policy that is only different in scale but not in substance from China's. For example, the U.S. has the DARPA [Defense Advanced Research Projects Agency] program, its world-renowned national laboratories under the Department of Energy, the massive research funding from the National Institutes of Health, and the many grants from the National Science Foundation programs. A few days ago, President Trump signed an executive order to promote artificial intelligence development. That smacks every bit of industrial policy.

Having said that, I think it doesn't hurt China's interests in focusing on a policy objective of excelling in select areas as opposed to being mediocre in all things. For example, the U.S. has pride in its Boeing airplanes, while China has prides in its high speed railway. Some Washington think-tanks accuse China for being an innovation autarky. But if an autarkical approach is to be avoided, strategic trust needs to be established between the two sides, for the long term. And in this regard, recent actions from Washington, especially from the intelligence and the defense complex wings of the executive branch regarding Huawei, are very disappointing. Huawei may have made mistakes in the past in other areas, but there has never been a shred of evidence that the company is engaged in intelligence and espionage work for the Chinese government.

Washington's conviction-by-hypothesis is built on a statute in China, called Intelligence Law, Article 7, which says corporate entities in China have the obligation to cooperate with the government. But there is a higher constitution in China, which says the government protects private companies' interests. Huawei's CEO, Mr. Ren Zhenfei said very clearly that he would never put his customers' interests ahead of anything else, and his statement does have a legal basis—which is what I am talking about—the point that the Chinese government, according to the constitution, should never put Huawei in harm's way on the global market.

So, I'm going to skip a few slides.

Another dimension of escaping an economic "Thucydides Trap" is along the market geographic dimension. Corporate America usually does not go to

Africa. Corporate America is limited in its presence in South America, South Asia, and Southeast Asia. Its strength is in Europe and the North America markets. I have always advised corporate China executives to go to Africa, to go to South America, and to those places where there are more opportunities than competition. By a friendly geographic division of the global market, corporate China and corporate America can both thrive on their own.

### The Belt & Road Initiative

Last I want to talk about the Belt and Road initiative and its potential implications for Chinese investment in the U.S. Foreign direct investment between the two countries strengthens our economic relations, serving as an additional layer of ballast to our overall relations. In terms of foreign direct investment, so far it is predominantly a one-way street from America to China. This is all understandable given the developed economy status here vis-à-vis China. But in more recent years, more and more Chinese capital is interested in the U.S., particularly in the South, in states like North Carolina, South Carolina and Georgia, where costs of land and utilities are cheaper than in China and the labor cost is quite reasonable. This is particularly true in the context of the new economic geography theory, which posits a migration pattern of industrial manufacturing clustering.

Historically it migrated from Europe to the North America, and then to Japan and South Korea, and then to China. It has been in China for over 30 long years, such that we are starting to see a wave of outward foreign direct investment out of China, much like corporate America's offshoring movement in the 1990s. You would like to see some of this corporate China's *offshoring* capital as part of *reshoring* back to the U.S., as many of those companies are active participants of the global value chain networks encompassing the North American market.

Chinese capital investment in this country can also be in the area of infrastructure investment against the context of President Trump's "Make America Great Again" campaign. This is President Trump's hallmark campaign slogan. But so far we haven't seen many actions and details coming out of the administration about the infrastructure buildout, other than that Wall on the southern border with Mexico. President Trump said that would be his focus in the second half of his term. We will see.

Infrastructure buildout is a great strength of Chinese companies. For those of you who have visited China, you can tell how much China has made great strides over the years. Now the government is doing this in the Belt and Road initiative. But there is much confusion, misunderstanding, misinformation and even malicious attack of the Belt and Road initiative. This is not a geopolitical play to promote sphere of influence. This is not intended for power projection. The Belt and Road initiative is truly motivated by seeking mutual commercial interests as opposed to promoting an ideology in competition with America. This point has been repeatedly emphasized by the Chinese government.

China has a huge foreign exchange reserve sitting idle here in the U.S. Bank of China and other major commercial banks from China are now flush with dollar cash and other dollar-denominated liquid assets, totaling over $3 trillion, mostly in the form of holdings in U.S. Treasury bills and bonds. This money can be readily used for Chinese investors to participate in America's infrastructure boom. By that I mean Chinese investors can participate in those infrastructure projects as active equity investors, and maybe contractors or suppliers at the same time.

Call it belt-and-road. Call it the America-belt-and-road. It doesn't matter, as long as China's current account trade surplus can be somehow transformed into a capital account stock, in the form of money invested in America as permanent equity shareholders, and more importantly permanent stakeholders, of a stable and prosperous Sino-U.S. economic relationship. This could be a win-win model for both countries.

In conclusion, I am optimistic about the short-term trade negotiations, but worried about the poisonous political atmosphere in Washington, D.C., regarding China in the long run. There are those political factions in the U.S.—those on the right representing the defense industrial complex and the intelligence community, and those on the left for a phantom ideological crusade—who are bent on making China public enemy number one in the U.S. This is deplorable, to say the least.

Fortunately President Trump doesn't seem to be part of it. A good relationship between our two countries, albeit being competitive in nature as long as it is peaceful competition, is indeed fundamentally in the American interest.

Thank you very much for the opportunity and I wish you all great success.