

MEMORANDUM

TO:	Dr. Richard N. Haass, President of Council on Foreign Relations
FROM:	Patrick Campbell
SUBJECT:	China's Economic and Military Power
DATE:	March 29, 2019

ABSTRACT

US economic policy toward China since the Cold War has been driven by the assumption that expanding trade and investment was in the United States' interest.¹ However, the dramatic growth of China's economic and military strength over the last 30 years, combined with its increasingly muscular foreign policy, demands that this basic assumption be reexamined. It is now clear that the US' economic policies toward China have not only failed to achieve many of the benefits for which they were intended, but have, in many regards, made the relationship between the two powers more precarious. The most serious threat that China poses to the US is in relation to its economic policies, which have become the country's preferred means of advancing its military and political ambitions. The new goals of US-China policy should be, first, to strengthen its own economy through strategic investments in key sectors of the domestic market and shoring up the legal and institutional mechanisms that support fair global economic competition; and second, to make it more difficult and costly for China to advance its ambitions for a new Eurasian order by increasing investment to those nations that are most vulnerable to China's economic diplomacy and negotiating stronger contractual enforcement mechanisms.² Adopting these policies will allow the US to maintain its competitive edge, strengthen its ties to Central and East Asia, protect American welfare and national security, and preserve its influence in the continued evolution of the international order.³

I. INTRODUCTION

China's current political ambitions under Xi Jinping can best be understood as an attempt to reclaim the regional pre-eminence the country enjoyed before its so-called "century of humiliation."⁴ This "Chinese Dream" is one with which the general Chinese population deeply resonates, but which provokes deep anxiety from China's neighbors who understand it to be closely linked with military might.⁵ Soon after becoming Communist Party chief, Xi acknowledged as much, stating that "to realize the great rejuvenation of the Chinese nation, we must preserve the bond between a rich country and a strong military, and strive to build a

consolidated national force.”⁶ According to this reasoning, a powerful economy will allow China to pay for the strong military needed to ensure that they are never again invaded and occupied.⁷

China's economic transformations

In December 1978, China opened its economy to the outside world leading to a number of significant both for the global economy as well as for China itself. With an estimated GDP of \$14.2 trillion,⁸ China currently possesses the second largest economy and is forecasted to soon surpass the United States.⁹ Even more remarkable is the pace with which China has achieved this growth, transforming itself, in the words of one analyst, “from a largely isolated backwater into one of the biggest trading nations and investment destinations of the global economy in less than 30 years.”¹⁰ This impressive feat is credited, among other things, with raising some 800 million Chinese out of poverty.¹¹ Other highlights of China's newfound economic power include:

- In 2009, becoming the world's largest exporter of goods and the second largest importer¹²
- Being the top trading partner of every country in East and South Asia¹³
- Having a trade ratio of more than 66% at its peak in 2006, making China one of the most open large economies in the world¹⁴
- Holding 30% of all global foreign currency reserves¹⁵
- Continuously being the second most prominent target of inward foreign direct investment (IFDI) and increasing its outbound foreign domestic investment (OFDI) by 50% annually from 2002 to 2009¹⁶

The strongest evidence of China's deepening strategic ambitions is provided by its creation of the Asian Infrastructure Investment Bank (AIIB) and the Belt and Road Initiative, both of which are designed to build needed infrastructure in Asia and tie the rest of Asia more closely to China's economy.¹⁷ President Xi routinely sells these initiatives as part of a unified “Asian Dream,” claiming the initiative will break down investment barriers, open new trade routes, improve international logistics, increase regional financial integration, and even promote world peace.¹⁸ China's neighbors, however, recognize this “win-win” diplomacy as designed to serve China's own interests first¹⁹ and have therefore concocted various schemes for extracting as much economic benefit from China without losing their political and economic sovereignty.²⁰

China's military transformations

Current Chinese military thinking is largely guided by a combination of Deng Xiaoping's doctrine of the “people's war under modern conditions”—which holds that Chinese defense

should begin at China's borders, not beyond, and should rely more on mechanized, better-equipped forces than on human factors²¹—and the Maoist concept of “active defense,” which prescribes employing offensive measures only to prevent or defuse crises or to stem conflicts over China's national sovereignty.²² The strongly inward focus of these philosophies is partly to blame for the general state of disrepair that has characterized the country's military up through the 1980s. Since the 1990s, however, China's military leadership has managed to secure large increases in military funding as part of the PRC's “four modernizations” program,²³ driven by a dual strategy of: (1) “leapfrog” development (making technological leaps by relying on existing technology available to the international market) to quickly gain niche capabilities for waging asymmetric warfare, especially through space, cyber, and electronic capacities;²⁴ and (2) mechanization and “informationization” (a strategy involving the digitalization and networking of all relevant military activities into a high-technology information infrastructure).²⁵

By these means, China has been able to achieve a number of significant transformations in its military power, the most notable of which include:

- An estimated military budget of between US\$90-180 billion, representing almost 2% of the country's GDP²⁶
- Double-digit growth rates of state funding for the army over the last 20 years²⁷
- The largest navy in Asia with about 220 surface vessels and submarines²⁸
- A standing army of 1.25-1.5 million equipped with more highly advanced offensive and defensive capabilities²⁹
- A modernized air force with vast improvements in paratrooper capabilities, air defense, and radar systems with air-to-air guided missiles and precision-guided ammunition³⁰

US-China Relations

For the past 40 years, the United States has enjoyed relatively fruitful relations with China thanks in large part to its Open Door Policy. While certainly not perfect, this approach has helped achieve many significant foreign policy “wins” for the US, ranging from the successful containment of the Soviet Union during the last two decades of the Cold War (in which Chinese cooperation played a vital role) to helping ameliorate the relationship between the US and China following the Korean and Vietnam wars.³¹ These successes testify to the basic wisdom of choosing engagement as the foundation of US-China policy rather than the alternative of

disengagement, which will only result in greater misunderstanding, mutual alienation and hostility, and damage to stakeholders on both sides.³²

Nevertheless, the dramatic growth of China's economic and military power over the past 30 years demands that the US adopt a new set of policies that better reflect the current reality and are proportionate to the nature and magnitude of the Chinese threat. At this point, China does not pose a serious military threat to the US. While its behavior has not always aligned with its peaceful rhetoric, there is little evidence to suggest that China's ambitions for territorial expansion go any farther than the South China Sea and a handful of other locations it considers pertinent to its national security. Chinese aggression in these regions, while certainly troublesome, does not present any immediate cause for concern to the US.³³ If such conflicts should arise in the future, China would be still be deterred by the vast superiority of the US' military capacity (which most analysts believe is still well capable of neutralizing Chinese niche capabilities) and unrivaled military budget, which in 2012 exceeded US\$700 billion.³⁴

Where China poses a much more credible threat to US interests is in relation to its economic practices. Despite its promising beginnings under the leadership of Deng Xiaoping and Zhu Rongji, China has failed to commit unequivocally to the market-based development either domestically or abroad, resorting instead to a series of quasi-mercantilist policy tools engineered to gain political advantage and challenge key aspects of the prevailing regional and international order.³⁵ Neither has China lived up to the promise of its succession to the World Trade Organization. Rather, the country maintains a range of discriminatory market barriers and restrictions on investment—most notably through its joint venture requirements, which have systematically facilitated the theft of intellectual property. Finally, while our previous assessment did not see China as a current military threat, its economic power provides alternative reasons to be wary of China's unchecked growth over the long-term. Other things being equal, a country with a larger GDP will have a greater ability to generate military power and sustain a prolonged conflict (or peacetime strategic competition) than a country with a smaller one.³⁶ By adopting the policies outlined below, however, the US can effectively counter the more nefarious elements of China's economic strategy and help guide their ambitions for national rejuvenation in a more lawful and mutually beneficial direction.

II. RECOMMENDATIONS

R1: Increase investments in key sectors of the domestic market, especially in relation to critical infrastructure and emerging technologies, and strengthen the legal and institutional mechanisms that support fair economic competition.

The best protection against a strengthening Chinese economy is a strong and resilient US economy. To achieve this, the US should first work to build domestic capacity by increasing funding for education and basic scientific research and improving immigration laws to better facilitate the influx and retention of talent in relevant fields. Highest priority should be afforded to those sectors that are most essential to national security—namely, those needed for the routine maintenance and improvement of critical infrastructure as well as those supporting the development of new, cutting-edge technologies. The US should also increase investment in “moonshot” projects to spur development in cutting edge technologies like high-end semiconductors and quantum computing.³⁷

Such measures cannot guarantee a strong and resilient US economy on their own, however. Well-designed and properly functioning legal and institutional mechanisms are also required to maintain fair, safe, and competitive economic environment. One piece of this puzzle is broadening the mandate of the US’ Committee on Foreign Investment to enable it to apply greater scrutiny and possibly block proposed acquisitions whenever American welfare or national security is at stake.³⁸ The US should also tighten the rules and procedures for overseeing and reviewing proposals for foreign direct investment. To the extent possible, the US, along with the EU, Japan, Canada, Australia, and other like-minded countries, should negotiate with China to encourage them to more faithfully adhere to the commitments and obligations they accepted upon their accession to the WTO. In the case that such negotiations fail, however, the US and its allies should not hesitate to pursue retaliatory measures against China for any unacceptable conduct.³⁹

R2: Strengthen alliances in Central and East Asia by increasing US participation in regional free trade agreements (FTAs) and negotiating stronger contractual enforcement mechanisms to promote greater Chinese compliance.⁴⁰

Many of China’s current advantages stem from economic practices that foster resentment and suspicion from the countries they target. China’s inability to achieve growth without alienating its neighbors creates valuable opportunities for the US to strengthen its alliances in this region. To capitalize on these opportunities, the US should increase investments in regional free trade agreements (FTAs) with those countries that are most susceptible to China’s economic

diplomacy but whose relationship with China is the most strained, such as Myanmar, Vietnam, and the Philippines.⁴¹ Even if their economic impact is limited, FTAs can serve as tokens of US commitment to the security and welfare of its friends and allies and strengthen long-term ties to the US and to one another.⁴² while simultaneously reducing these countries' economic dependence on China.⁴³ Furthermore, by setting higher standards and excluding countries that do not meet them, FTAs can provide an additional incentive for Chinese reform, encouraging its leaders to abandon statist policies, embrace the market, and become more fully integrated into a truly open global economy.⁴⁴

III. CONCLUSION

The dramatic growth of China's economic and military power over the past 30 years calls for the US to adopt a new set of economic policies. The new goals of US policy toward China should be, first, to strengthen its own economy through strategic investments in key sectors of the domestic market and the shoring up of the legal and institutional mechanisms that support fair global economic competition, and second, to make it more difficult for China to advance its ambitions for a new Eurasian order by increasing investment to those nations that are most vulnerable to China's economic diplomacy and negotiating stronger contractual enforcement mechanisms⁴⁵ By adopting this agenda, the US will be able to better maintain its competitive edge, strengthen its ties to Central and East Asia, protect American welfare and national security, and preserve its influence in the continued evolution of the international order.⁴⁶

¹ Aaron L. Friedberg, "Rethinking the Economic Dimension of U.S. China Strategy," (American Academy for Strategic Education, 2017), 1.

² Ibid, 19.

³ Ibid, 20-21.

⁴ Tom Miller, *China's Asian Dream: Empire Building Along the New Silk Road*, (London: Zed Books, 2017), 8; see also Sebastian Heilmann and Dirk H. Schmidt, *China's Foreign Political and Economic Relations: An Unconventional Global Power*, (Lanham: Rowman and Littlefield, 2014), 146.

⁵ Jeffrey Bader, "U.S.-China Relations: Is It Time to End the Engagement?" (Brookings Institute Policy Brief, 2018), 2.

⁶ Friedberg, *Rethinking U.S. China Strategy*, 9.

⁷ Ibid, 9.

⁸ "IMF report for China," (International Monetary Fund, 2018).

⁹ Friedberg, *Rethinking U.S. China Strategy*, 8.

¹⁰ Heilmann and Schmidt, *China's Foreign and Economic Relations*, 83.

¹¹ Sara Hsu, "Can China Wipe Out Poverty by 2020?" *Forbes*, (August 19, 2016).

¹² Heilmann and Schmidt 2014, 83.

¹³ Bader, "U.S.-China Relations," 2.

¹⁴ Heilmann and Schmidt, *China's Foreign and Economic Relations*, 83.

¹⁵ Ibid, 90.

¹⁶ Ibid, 97.

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- ¹⁷ Bader, "U.S.-China Relations," 2.
- ¹⁸ Heilmann and Schmidt, *China's Foreign and Economic Relations*, 30.
- ¹⁹ Ibid, 29.
- ²⁰ Ibid, 18.
- ²¹ Ibid, 54.
- ²² Ibid, 56.
- ²³ Ibid, 57.
- ²⁴ Ibid, 56, 64-65.
- ²⁵ Ibid, 55.
- ²⁶ Ibid, 58.
- ²⁷ Ibid, 57.
- ²⁸ Ibid, 62.
- ²⁹ Ibid, 60-61.
- ³⁰ Ibid, 63.
- ³¹ Friedberg, *Rethinking U.S. China Strategy*, 1-2.
- ³² Bader, "U.S.-China Relations," 6.
- ³³ Heilmann and Schmidt, *China's Foreign and Economic Relations*, 17.
- ³⁴ Ibid
- ³⁵ Friedberg, *Rethinking U.S. China Strategy*, 1.
- ³⁶ Ibid, 14.
- ³⁷ Ibid, 13.
- ³⁸ Ibid, 10.
- ³⁹ Bader, "U.S.-China Relations," 4.
- ⁴⁰ Friedberg, *Rethinking U.S. China Strategy*, 13, 15, 17.
- ⁴¹ Miller, *China's Asian Dream* 19.
- ⁴² Friedberg, *Rethinking U.S. China Strategy*, 20-21.
- ⁴³ Ibid, 18.
- ⁴⁴ Ibid, 13.
- ⁴⁵ Ibid, 19.
- ⁴⁶ Ibid, 20-21.