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Interview with Dr. Kenneth G. Lieberthal
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USAPC: You have described China as “a group of relatively developed islands with a cumulative population of over 400 million people that are scattered around in a sea of over 800 million people who live very much in developing country conditions.” Please elaborate on how this affects China’s perception of its economic status, particularly with respect to the climate change debate.

Lieberthal: Until a couple of decades ago China, by anyone’s definition, was clearly a developing country and a fairly poor one at that. Since then, it has achieved remarkable economic growth, but this growth has been very uneven geographically.

When foreigners come to China they tend overwhelmingly to congregate on the east coast in major metropolises as well as at a couple of major tourist destinations inland. Those are the areas that have benefited most dramatically from this economic growth. They create an image of a China that not only is 21st century, but also in some respects ahead of industrialized countries.

But if anyone travels in China’s interior or lives in parts of these cities that are not the glitzy places where foreigners tend to congregate, one would see that the country’s modernization in fact is extremely uneven. There are a lot of gaps.

Chinese who come to the United States often say, “Well, on the one hand you don’t have the dramatic view of all these phenomenal new structures in Shanghai, but on the other hand, everything works!” Everywhere you go in the United States, from small towns in the Midwest to large cities, is well put together. That simply is not the case in China. There still is an enormous amount that has yet to be brought up to speed.

So when Chinese leaders look at their country, they see the problems of a developing country even as they also see the problems of a modern country -- because they govern both. The two sides of that equation interact intensively across the board.

For example, those big modern cities are magnets for rural migrants who come, not in the tens, hundreds, or even thousands, but in the millions. The government has to build structures to house them, provide basic services, and manage their social and economic integration into the urban areas without fundamental disruption.

Attending to all of those needs requires a level, speed, and type of economic growth that the West doesn’t fully understand. But we need to understand this because it ultimately affects China’s willingness to impose absolute limits on greenhouse gas emissions. Chinese leaders say their country needs too much steel, cement, aluminum, and new electric power to be able to

conveniently take on those limitations. The best they can do, they say, is to be less egregious in their emission of greenhouse gases per unit of output than they've been before. "But given where our output must go, you can't reasonably expect us to match your record in putting a cap on and then applying reductions to overall emissions -- because frankly, we couldn't do it even if it were our top priority."

USAPC: As we saw during the Copenhagen climate talks,¹ the Chinese also have problems with some of the proposals aimed at ensuring verifiability of greenhouse gas reductions.

Lieberthal: Yes, the Chinese have been very tough on that issue for a mix of reasons. First, there is the matter of sovereignty, and the Chinese are very sensitive about sovereignty. The United States also is very sensitive about sovereignty so we should be able to understand their views and they should be able to understand ours. Neither of us likes others poking their noses in and telling us what is actually going on in our countries and what we should do about it. This doesn't sit well in either society – admittedly for different reasons – but nevertheless it doesn't sit well.

Beyond that, I would suspect China continues to be nervous because at a national level it has adopted a number of very forward-leaning policies on greenhouse gas emissions and energy efficiency. Beijing put money behind those policies and has approved projects and passed regulations to give them real teeth. But the Chinese government is a multi-layered, bureaucratic leviathan. What starts off at the top tends to get adjusted as it goes down through the system. The capacity of central government officials to know accurately what is happening on the ground is more limited than most Americans understand.

For example, when the Chinese build a new power plant, they equip it with world-class technology for efficient burning of coal. For the most part, China builds coal-fired plants. I imagine they estimate emissions from new plants based on the assumption that the plants are operating according to specifications.

However, U.S. investigators, mostly from academia, who last year visited power plants around South China discovered something interesting. Most of the coal used in these power plants is supposed to come from a huge basin in northern China. This basin produces higher quality coal, which also is more expensive.

But investigators found in talking to local plant managers that when economic times get tough and their profits begin to drop, they discontinue buying the coal from the northern basin and instead use local coal, which is of much lesser quality. Unfortunately, burning the lower-quality coal permanently interferes with the operation of some of the more sensitive sensors and other high-efficiency equipment, which causes the equipment to perform below specified standards. When the plant resumes using the high-quality coal later on, it continues to perform below standard.

¹ The 15th United Nations Climate Change Conference (COP15) was held in Copenhagen, Denmark, December 7–18, 2009.

I think Chinese officials probably are worried about what international inspectors might uncover on the ground that they themselves in good faith don't know about. They are trying to count their emissions accurately, but they are doing it within the constraints of their own capabilities. In addition, they may be worried about losing face against a backdrop of increasing pressure to improve their game.

So for a variety of reasons, the Chinese have been very recalcitrant on transparency, beyond telling you what they are doing and what they are accomplishing. I think it's going to be hard to get them to change.

Nevertheless, quite a few Members of the U.S. Congress remain very concerned about verification of Chinese commitments. Their view – which I think is wrong -- is that the Chinese say they are reducing their emissions, but in fact they are lying. By contrast, when we in the US say something, we actually do it.

The reality is that at the national level, what the Chinese say they mean, and they put resources behind it. But this is a country that still has a great deal of developing country capabilities, so they cannot accomplish it all. The intentions of the Chinese are better than many Members of Congress apparently believe. And their performance also is better than many U.S. lawmakers think -- but their performance probably isn't as good as they say it is or that they believe it is. And so you can see the politically difficult choices this creates.

USAPC: One of the high points of the Obama-Hu summit in November 2009 was their agreement on a package of seven initiatives aimed at strengthening bilateral cooperation on clean energy. You have spoken about how both countries bring complementary capabilities to this initiative. How do you think elements of the clean energy package will bear fruit in the coming months and years?

Lieberthal: These agreements were very well structured. Substantively, they address clean energy from a wide variety of angles, from electrical vehicles, to clean coal (especially carbon capture sequestration), to joint research labs doing some fairly fundamental science on clean energy. In addition, each initiative is quite sensitive to what each side can contribute and how the end product would be in the interests of both sides.

This is not a set of agreements in which the United States gives aid to China and then lets China go off and do its own thing. It is not a set of agreements that calls for a straight technology transfer from the United States to China. The agreements recognize that there are many areas where, if the two countries combine our knowledge and capabilities, they may be able to develop something that is world-class which we both will own and can apply in our own markets as well as to the world.

The development of electrical vehicles is a good example. China has some good battery technology and strong manufacturing capabilities, while the United States brings to the table vast experience in vehicle design, sales, service, and finance. The same complementarity exists with respect to carbon capture sequestration.

Moreover, these initiatives aren't huge "make or break" projects. They are modest in scale at the beginning, but are structured so they naturally can expand and become more

important over time. Through such joint efforts we can build trust and expand our ability to work together.

USAPC: So you think that success on clean energy cooperation can spill over into other aspects of U.S.-China relations?

Lieberthal: It certainly has the up-side potential to do that because clean energy is one of those areas in which we have major shared interests. Of course, there is a competitive dimension too, but there are major shared interests. The importance of the issue, moreover, will inevitably grow over time as the effects of climate change become more dramatic.

Perhaps most important, the clean energy projects enable the kind of joint cooperation that goes far beyond the normal sphere of diplomats, national security experts, and economic and trade specialists. This initiative will bring together whole communities from major universities, the corporate sector, and the scientific community that normally don't deal with each other on a large scale. We have the potential over time to create a much larger and more diverse community of people in both the United States and China who are seriously engaged with their counterparts in a multi-decade effort that can benefit both sides enormously as well as benefit the world – particularly since our two countries emit over 40 percent of global greenhouse gases.

So we're getting off to a good start, and that is why I appreciate the nature of the clean energy agreements. A "good start" here is not something that is big, brash, or showy. It entails building the fundamentals necessary to realize effective cooperation that can be expanded over time.

In a political sense, I think these agreements actually hurt President Obama because the China summit didn't produce a big, dramatic breakthrough that reporters who really don't know much about the issues can write about. Although the White House issued fact sheets and provided media briefings about the President's China visit, I didn't find one single American news outlet that even listed the seven clean energy agreements, much less explained what they will entail. I believe the President did the right thing in terms of real effectiveness but these agreements are not the kind of achievements that generate breathless press coverage.

USAPC: In general, the American media did not portray the China leg of President Obama's Asian tour in a very positive light.

Lieberthal: Yes, I agree. I suspect that was because the White House press corps who travel with the President are by their very nature experts on the presidency and not on issues in Asia or technical matters. So regrettably, what they tend to write about is what they know, which tends not be what's most substantively important in these visits.

I was in Beijing during the visit and involved in some ancillary activities, although I was not part of the official party. At the time, I thought the visit went very well. On balance, this visit did what it was intended to do. It reframed the relationship. In particular, it introduced in a very prominent and very visible fashion that, for the first time, global issues have moved to the center of the U.S.-China relationship. These are the global economic/financial architecture, clean energy/climate change, and nuclear nonproliferation – not just North Korea, but Iran and other places too.

The Obama-Hu summit was built around these three global issues and their Joint Statement reflected this, although the press managed to miss all of this. The journalists traveling with the President tended to focus on the fact that the students who participated in the “town hall” meeting with President Obama were specially chosen. But it is inconceivable that they wouldn’t have been specially selected.

Moreover, does that mean that the President can’t say what he wants to say? Any good speaker – and President Obama is a very good speaker – can take almost any question and find a way to segue into what he wants to say. And in fact, a large part of that town hall meeting was available for Chinese viewing on a widespread basis.

So I thought the U.S. press did not convey the real value of what occurred in China. The summit didn’t resolve all the issues in bilateral relations by any means, but more informed coverage of the summit would have conveyed a different impression.

USAPC: There is a view in some American quarters and among some Asians that the United States has become China’s supplicant, of sorts, owing to the enormous U.S. debt held by Beijing. Does China enjoy a greater degree of leverage in its relations with the United States because of the economic imbalance?

Lieberthal: I recently had occasion to dig up the particulars about China’s debt holdings of U.S. sovereign and agency debt. By this I mean the Treasury bills they purchased as well as debt from Fannie Mae and Freddie Mac.²

The numbers are really quite startling. China holds less than 7 percent of outstanding Treasury bills and less than 7 percent of Fannie and Freddie debt. China’s foreign direct investment in the United States is 0.1 percent of total foreign direct investment. Chinese entities’ U.S. stock market holdings are a comparably small figure.

So the reality is that China has invested a very significant portion of its foreign exchange holdings in U.S. debt instruments. It is the largest single holder of those debt instruments. But the holdings of those debt instruments are so widely distributed that China’s holdings give it virtually no leverage. Not only that but, ironically, U.S. debt paper has never been easier to sell than during the global economic crisis this past year. We’re offering almost no interest rate and still are having no trouble moving our debt because of the flight to safety.

To personalize this, our current situation reminds me of a hypothetical case where most of my disposal income is tied up in investments in one company. I would care enormously how

² The Federal National Mortgage Association, also known as Fannie Mae, was chartered by Congress in 1968 as a government-sponsored enterprise. Its mission is to provide “liquidity, stability and affordability to the U.S. housing and mortgage markets.” Fannie Mae operates in the U.S. secondary mortgage market. Rather than making home loans directly to consumers, it works with mortgage bankers, brokers and other primary mortgage market partners to help ensure they have funds to lend to home buyers at affordable rates. Fannie Mae funds its mortgage investments primarily by issuing debt securities in the domestic and international capital markets. In 1970, the U.S. government created the Federal Home Loan Mortgage Corporation, also known as Freddie Mac, to compete with Fannie Mae and ostensibly create a more robust and efficient secondary mortgage market.

that company performed. But from the company's perspective, if I only held 6 percent of that company's outstanding stock, I wouldn't be able to significantly affect that company's decisions.

Analogies are not perfect, but that one helps to explain the current relationship between China and the United States. The imagery has become distorted from reality. It would be helpful to everyone if the real numbers were made more visible and explained more fully. Chinese purchases of U.S. debt at this point are important but not critical to the sale of the U.S. debt. But how the U.S. handles the dollar is critical to China. That should not produce a situation where the U.S. feels it must do whatever China says so you don't upset your banker. The dependence runs significantly in the other direction.

To my mind, the reality is that the debt connection of our relationship exists, is important, but is one of a number of important dimensions of our relationship. Overall, we're important enough to each other that we need to deal with each other with respect and as adults. The notion that either of us can simply jerk the other around is wildly unrealistic. At the highest levels of the U.S. and Chinese governments, this reality is understood. But the average person in both countries not does understand this well.

USAPC: As you mentioned, nonproliferation also was an important agenda item during President Obama's visit to China. You have said that the road to securing China's support for United Nations sanctions aimed at punishing Iran for its nuclear program "goes through Moscow." Would you please elaborate on this.

Lieberthal: We have made very clear to the Chinese how important the Iran nuclear issue is. If Iran should acquire a credible nuclear weapons capability, it would have enormous repercussions in that part of the world – which has enough trouble already.

The Chinese have said they are very concerned about the Iran nuclear issue, but officials have argued that sanctions do not work and often are counter-productive. They simply disagree with us as a matter of efficacy as to how much can be done through the use of sanctions.

Having said that, though, China joined the United States in supporting a resolution that found Iran to be in violation of its obligations as a member of the IAEA [International Atomic Energy Agency]. The vote occurred on November 27, 2009 at an IAEA meeting. The really important vote probably will occur in January 2010 in the U.N. Security Council. I think there will be a finding by then that Iran is not being responsive to the P5-plus-one process. The Security Council then likely will vote to punish Iran with very tough sanctions.³

That is the context within which I said the road to securing Beijing's support goes through Moscow. I think the Chinese really don't want the Security Council resolution to be adopted. But the Chinese really, really do not like to be the only ones on the outside when all the major powers are considering a major, sensitive issue.

Chinese officials apparently hope that the Russians won't support it and they can then hide behind the Russians. But if the Russians do support the Security Council sanctions, China

³ The P5-plus-one group includes China, Britain, France, Russia, the United States and Germany. This group was formed to negotiate with Iran on ending its nuclear program.

will find itself all alone. And faced with that prospect, they likely will negotiate hard to take some of the edge off the resolution, and then join the rest of the members of the Security Council in supporting it.

USAPC: China also has been reluctant to aggressively enforce sanctions against the other threat to proliferation, North Korea. What would it take for China to recognize that Pyongyang's nuclear ambitions ultimately could affect its stability?

Lieberthal: Frankly, I don't think a nuclear North Korea threatens China's stability. Nevertheless, they strongly oppose a nuclear North Korea. And they oppose it primarily because they are concerned that a nuclear North Korea will lead to a nuclear Japan and conceivably a nuclear South Korea. In addition, they don't like that a nuclear North Korea invariably will be at loggerheads with its neighbors and with the United States, which creates the potential for instability in the region.

China's concerns about the domestic impact of Pyongyang's nuclear ambitions grow out of an unstable North Korea -- moreso than a nuclear North Korea. If a succession crisis creates instability in North Korea, China would be quite worried about refugee flows, loose nukes and who would be controlling them, South Korean and U.S. forces being drawn into peacekeeping and stabilization efforts and the PLA [China's People's Liberation Army] possibly being drawn in on the other side, among other issues. There would be all these military forces operating in a highly unstable environment potentially without the benefit of effective communications among them.

I think those are the reasons why China is serious about trying to secure the denuclearization of North Korea. Where the United States and China disagree is that China is more reticent to take tough measures to pressure North Korea than we are precisely because they fear the destabilization of its neighbor. The United States is concerned, but China is **very** concerned because it shares a border with the North. If it comes down to where that distinction becomes critical to policy, then I think we may see us in substantial disagreement on that.

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