

Fairbank Center Director's Seminar – Myths and Realities in Sino-American Relations, November 12, 2020

– Good afternoon. Welcome to the third director's seminar series of the Fairbank Center. Today, we're very delighted to have Bill Overholt presenting "Myths and Realities in Sino-American Relations" to us. This is most timely given the election result that we experienced in the last weekend, and Bill is no stranger to you. Since 2013, Bill has been working with Ezra Vogel and Bill Hsiao to organize the critical issues confronting China seminar series at the Fairbank Center. It has been one of the most successful seminar series that has been running for seven years on a weekly basis. Professor Overholt is senior research fellow at Kennedy School's Mossavar-Rahmani Center for Business and Government, and we're very delighted to have him to share his insight and wisdom with US on Sino-American relation. We also delighted today to have Professor Vogel and also professor Larry Summers to moderate the discussion. And with that, let me turn over to Ezra to introduce Bill.

– Well, it's my great pleasure to introduce Bill. I've had that pleasure of introducing him for our critical issues. I've known Bill since he was an undergraduate at Harvard several years ago, and since then, he did a PhD at. Is Larry's coming on?

– Yes.

– If Larry–

– Ezra [muffled speaking].

– If Larry is coming on, I will turn it over to Larry to introduce him. Is that right?

– Hi, Larry.

– Hi, Larry. I'm passing it on to you to introduce Bill.

– Hi, Larry. Welcome. We just gave a brief introduction, and we were just going to turn it over to you to introduce Bill and also moderate the session. Thank you.

– I'm delighted to have the opportunity to be part of this. I think what the Fairbank Center does is extremely important, and in all the time that Ezra has been working to understand China, there has not previously been a more important moment to understand China than right now. We are all very fortunate to have the opportunity to hear from Bill Overholt. The center I'm honored to direct at the Kennedy School is very fortunate to have Bill as a senior research fellow. He has been toiling enormously effectively in these vineyards for many, many years of his many achievements. One that probably had the largest

impact on me was the book you wrote in 1993, prophesying most of what's happened to China economically at a time when that seems an absurd proposition. If you had said to me before I read Bill's book that in my lifetime, China would have had a GDP comparable to the United States, I would've found that to be a very implausible proposition. After I read Bill's book, I had a quite different view on that topic, and so it had an enormous amount impact on what I did at the World Bank and an enormous impact on my thinking during the time I worked at the US Treasury Department. Bill has continued to follow many different geoeconomic events, particularly with respect to China, and there's nobody I would rather hear from, and I'll be listening to see how many of the propositions he identifies as myths represent my prior beliefs before hearing him speak. Bill Overholt.

- Well, thank you very much to Winnie and to Ezra, to Larry, and to the Fairbank Center for sponsoring this. We're at a turning point in Sino-American relations. That means we're at a turning point in world history. What happens in the next few years will be scrutinized by historians a century from now. Others have predicted what the Biden administration will do. I want to examine some of the thought patterns behind China policy. The toughening of US-China relations is inevitable. China has changed in multiple adverse ways. One needs only to say the words Xinjun, Hong Kong, Huawei, intellectual property, Canadian hostages, South China Sea, Fox Hunt, influence groups to see the inevitability of change. Unpredictable US policy, sometimes frivolous US policy, has made things a lot worse, but the toughening includes almost the whole Western world and most of China's maritime periphery. I've said this. The US response has been based heavily on myths. My few first few sentences about the myths are gonna sound partisan, but I promise to offend everybody. Myth one about trade. President Trump has said that cutting off relations with China would say \$500 billion. That statement is based on the trade balance, but the trade deficit doesn't measure net benefits to a country. The most famous example is that when China assembles a Nike shoe, the trade balance shows minus \$100 for the United States, but only \$2 remains in China, and most of the benefits read down to Americans. China's trade surplus has been around 1% of its economy, almost perfect balance, so China is not the problem. The overall US trade deficit is basically what we say minus what we spend, and President Trump's tax deficits have greatly reduced what we save. He launched a trade war to reduce the trade deficit and restore manufacturing jobs, but the overall trade deficit has gone up, manufacturing jobs have been reduced, and costs for American families have gone up. The balance of interests depends on a different calculation. China is now the center of gravity of the world consumer market. For half a century, US baby boomers were the center of gravity of the global market, but now baby boomers like me have gray hair if they have any hair at all, and China and Asia are the center of gravity of the world market. If America cuts itself off from that new center of gravity, General Motors dies immediately, the broader US automobile complex collapses, Hollywood shrivels, Nike is

beaten by competitors, Boeing collapses, Apple declines, US luxury goods manufacturers almost all go under, and the US global role in the art and music industries will decline and much else. America mismanaged both that reality and the serious problems we have with China. I'll say more about the problems later. Myth two, the roots of our engagement with China. Leading advisors to president-elect Biden have spread the myth that US engagement with China was based primarily on a belief that economic engagement with China would make China a democracy or at least a liberal Western style society, notwithstanding some quotations from past presidents, political hype that's as fallacious a reading of the politics as Trump's reading of economics. The decisive arguments were always about peace and prosperity. Congressional testimony focused on balancing the Soviet Union, peace in Korea, nonproliferation, antiterrorism, piracy, environmental cooperation, and economic problems and opportunities. Interestingly on politics, at the most important turning point, which was a debate over most favored nation status for China, the most popular argument in Congress was the exact opposite of the Biden advisors' view. Led by Nancy Pelosi, the predominant Democrat view, asserted that continuing to have normal trade relations with China would appease and encourage dictatorship, not that it would induce democracy. Business community arguments were consistently decisive. Focusing on peace and prosperity were exactly the right issues. Engagement with China is the biggest single reason that the world has experienced a half century of big power peace and the most extraordinary increase in prosperity in global history. No longer is Africa stagnant. No longer does Latin America lead the world down in every financial crisis. The poorest countries, the most unstable ones that create the most problems for the United States are raw materials producers, and Chinese demand has lifted them up. For the first time in 315,000 years, the world has more food and basic goods than it needs. When China became a predominantly services economy in 2015, mankind decisively shifted away from backbreaking manufacturing work to more healthy services jobs. The poorest Americans have benefited enormously from the availability of inexpensive goods manufactured in China. American companies have flourished globally because of the efficiencies created by supply chains that go through China. China's [indistinct] of intellectual property and denial of market access have become severely damaging, no doubt about that; they require firm action. The US has to diversify away from total dependence on China for things like rare earths whose supply curtailment could cripple US in an economic war or a hot war, but Americans' future is not improved by a false ideological revision of history to justify a Cold War mentality. Myth three, jobs. Faced with a technologically driven decline of manufacturing jobs that has proceeded steadily since 1947, both parties in our Congress have found it politically convenient to blame China rather than technology for the declines. They then ignore the desperate need for measures to alleviate the suffering of vast numbers of Americans displaced from their jobs. Manufacturing jobs are going the way of agricultural jobs, which once employed 98% of Americans and

now about 2%. We were fortunate that when we were losing agricultural jobs to technological change, our leaders channeled our economic life into the manufacturing sector. They built the railroads and the roads and the legal systems to move people into manufacturing. Unfortunately, our current leaders have chosen the option of blaming somebody else. Research by MIT's David Autor and others shows that if the company in the company town goes down, people sit around feeling helpless. The market doesn't clear. People need help. But the strategy of the Democrat congressional leadership is to follow the lobbying rhetoric of the manufacturing unions. For them, the solutions to the tragedy of fly over country is to beat up on China. Because of their manufacturing political base, the Democrats refuse to confront the reality that we have to engineer a population shift into service jobs. They create the false hope of getting manufacturing jobs back, and they belittle the service sector as flipping burgers for McDonald's. China lost nearly 45 million manufacturing jobs while we were losing three million, but Chinese leaders move most of their people into services while Americans blame China. As a result, America's domestic social crisis and the rage against the political elite intensify. The Trump supporters are not irrational to abandon the Democrats for a leader who promises to bust up a bipartisan establishment that ignores their plight. As long as Pelosi and her supporters of the manufacturing unions lead the legislative Democrats and McConnell and Republicans squeeze down expenditures to solve social problems, the US relationship with China will be worse than it needs to be, and we are guaranteed another Trump in our future, as Pew research polls show because this dilemma support for democracy is declining in America. In the late 20th century, congressional China policy was determined by a dominant political center, leaders like Democrat Bill Bradley and Republican Richard Lugar. The reactionary union left and the ideological anticommunist right agreed on a radically xenophobic policy, and they disdained pragmatic calculations of national interest. But the extremes had very little leverage over policy, the center decided. In the new century, the center has vanished, leaving the extremes in charge. Congressional China policy is just a tail on this domestic political dog. Myth four, China as Superman. When China announces that it's going to take over all key industrial technologies, much of Washington seems to believe it and panics. China's 2025 and 2035 plans are in large part reruns of Japan's industrial policy in the 1970s, which also panicked Americans. Japan had some very expensive successes with that industrial policy in which top leaders gave advantages to favored companies and favored sectors. They had even more very expensive failures. The last big effort was called the Fifth Generation computer and artificial intelligence program. Artificial intelligence resonates even today. It was a total flop. China has more money for subsidies than Japan did, but China also has Japan's problems plus some uniquely Chinese ones, and China's resources are going to be more squeezed in the future. Xi Jinping's overarching priority for political control is at war with China's economic ambitions. Private sector investment in China has been

devastated. Americans who fear China should welcome China's waste of resources. It has subsidized its semiconductor with \$103 billion already and continuously falls farther behind. US and its allies can bolster their own semiconductor industries while maintaining a private sector competitive system. When a Chinese product like Huawei with 5G threatens to dominate the world because its competitors are largely excluded from the Chinese market, the West should ban that product. But panicky, broad protectionism is unhelpful. Another myth, foreign policy militarization. This isn't an intellectual myth. It's never spoken, but it's implicit in the way that Congress has allocated foreign policy resources since the end of the Cold War. Budgets reflect an implicit fallacy that, in the search for national security, only military power counts. Congress has gradually gutted the budgets for state AID and US information service. It has allowed the roles of crucial institutions like the World Bank, the IMF, and the WTO to atrophy. Meanwhile, Washington has spent \$6.4 trillion on recent wars and much more on top of that in preparation for future potential wars. Trump caricatured this process, but it's gone on continuously since the end of the Cold War. No strategy recommended over militarization. Military leaders, people like General Mattis, General McMasters, Secretary Gates have been announced the starvation of complementary institutions. But in wartime or during a hair-trigger Cold War, a frightened sober Congress allocates resources according to relatively coherent strategy. In peacetime, Congress allocates largely according to lobbying and campaign contributions. The military spent \$112,500,000 on lobbying last year and an enormous additional amount in campaign contributions and then subsidizing think tank and scholar league contributions that constitute indirect lobbying. The other vital institutions like the State Department had negligible lobbying support. Over militarization complements another myth that war with China is inevitable or nearly inevitable. Here, I'm going to say things that some of you have heard me say before. I've been saying in various different ways for 45 years, mostly with a positive response, but political scientists ignore them because they don't fit a kind of standard disciplinary discourse. I'm gonna keep saying them because they're a matter of life and death. Perhaps the most influential baseline view of the US-China relationship is the Thucydides's Trap. From the time of ancient Greece to World War II, the way you became a great power was use your military to grab pieces of your neighbor and then do it again and again. That process resulted in war between rising powers and established powers about three times out of four, putting aside that one out of four was very important. Things have changed in the modern world. Particularly, two critical things have changed. One, we've learned how to grow economies much faster, making economics much more decisive for international influence. Second, military technology, and not just nuclear weapons, have become hugely more destructive. So both sides are likely to lose if one or both pursue the traditional game of using the military to grab pieces of their neighbors. Now the path to becoming or remaining a great power has become primarily economic. You still need a powerful military, but

it protects the economic strategy. This is a fundamental change in the way the world works. To miss that is like an economist missing the Industrial Revolution. US economic strategy won the Cold War. We created a system that enhanced our own prosperity and built up a network globally of prosperous friends and allies. So the union put all its money into the military and went bankrupt. That's an economic victory. Similarly, Japan became a big power without much of a military. Germany became Europe's leader through economic superiority, not by doing it the way Germany used to do it. South Korea was totally inferior to North Korea through the 1970s, but it focused on its economy, and its economy is now 50 times larger than North Korea's. Indonesia started out after independence the traditional way. It claimed most of Southeast Asia, and its economy was a mess. It was the sick man of Asia. Then it gave up most of those territorial claims, focused on the economy, and became the acknowledged leader of Southeast Asia. In China, same thing happened. Deng Xiaoping cut back the military from 16% of GDP to 3% and settled 12 out of its 14 land border disputes in order to focus on the economy, and China became a major power long before the current military buildup started. So the path to becoming a successful big power has become an economic strategy protected by a strong military or an ally with a strong military. Predominantly, economic strategies differ from military strategies in that both sides can win. When Germany and France war, one wins, one loses. When the US and Japan or the US and China compete for leadership, both can win. That's a vital aspect of US-China rivalry. If the protagonists recognize the post-World War II realities as many Asian countries do, then the risk of hot war is greatly reduced. Of course, if the US or China behaves like a pre-World War II power, it can make the Thucydides's Trap a self-fulfilling prediction. And then Graham Allison's wonderful book "Destined for War" provides a brilliant exposition of the consequences. But gratuitous escalation of the risk of military conflict is not a law of history, particularly post-World War II history. A substantial part of the risk in US-China relations comes from failure to risk to acknowledge that the geopolitical game is now a geoeconomics game. Another myth, the US can't live with a big country that has a different system. That makes China an unlimited threat to the United States. Now this argument, led by a former aide to Vice President Dick Cheney, Aaron Friedberg, now at Princeton, is extremely influential, especially in the Pentagon. Their argument has historical roots in the conflicts with the Soviet Union and Nazi Germany who were trying to take over the world by military force. They were determined to impose their system on other countries, but different systems can coexist for long historical periods. The US relationship with China is not like the ideological conflicts with the Soviet union or Nazi Germany. While China has issues with democratic neighbors like South Korea, the Philippines, Singapore, Thailand, India, and Sri Lanka, it is not trying to change their systems into something more like China's. Unlike Putin's Russia, China is not making systematic attempts to undermine democracy in Europe and the United States. Today's world does have an ideological

proselytizer, namely the United States. Well, China argues that every country should choose its own system, Washington thinks that every country of every culture at every level of development should emulate US or European democracies. While US ideals of freedom and democracy are quite attractive around the world, in many developing countries like the Philippines, only a small elite knows how to organize to win an election, and only a small elite has the knowledge or the money to cope with a complicated legal system like ours. They typically provide wonderful education and health services to the elite, but they're not taking care of their people. So the people support a Duterte in the Philippines or a Modi in India and may admire superior Chinese economic success. The weaknesses of many democracies in taking care of their people are our problem, not China's. In the 1930s, the democracies also had terrible weaknesses, but they found ways to take care of their people, and they were so successful that they fended off fearsome challenges. If America has to fear a challenge that says every country should choose its own system, then Americans need to identify reforms that will make a Duterte or a Modi or a Trump superfluous. Last myth that I'll talk about, China's belt and road initiative, or BRI, is portrayed in Washington as an insidious attempt to subordinate developing countries through debt and was designed as an effort to undermine the post-war global, Western global system. The fable of a deliberate debt trap endlessly repeated by Assistant Secretary of State Stilwell and many others has been thoroughly refuted by every empirical study from the Rhodium Group in New York to the conservative national security-oriented Chatham House in London. BRI has many problems, including a buildup of debt from ill-conceived products and from projects unfortunately timed just before the COVID-19 crisis. Debt problems pose serious challenges for Chinese banks, and China has been struggling to solve them. Sometimes, as with Hambantota Port in Sri Lanka, a Chinese company gets enticed into a bad deal by a corrupt local administration. The deal becomes a white elephant when the politics changes, then revives when elections bring back the original party. Chinese companies' understanding of political risk reminds me very much of American and European companies' understanding of political risk back in the 60s and 70s. Though problems of the BRI project are largely the same ones that America found objectionable with Japan a generation ago, corruption, unreasonable subsidies, tight aid, low-quality goods, Americans negotiated with Japan and with Europeans who then provided tax subsidies for bribes. Eventually, the parties converged on some basic standards. China's BRI reforms of April last year were very similar to some of those early Japanese steps. Convergence comes not because the different sides love each other. It comes because it's in their country's interest to solve the problems that come with these bad strategies. In conception, BRI was the ultimate tribute to the Western system. The US won the Cold War by creating a community of prosperity led by development banks, World Bank, Asian Development Bank, and others that lent for infrastructure plus institutions to create common standards and manage crises, the IMF, GATT, the WTO, and institutions

to expand trade and investment. That's what China's BRI is trying to do, development banks lending for infrastructure, efforts to create common standards for everything from railroad gauges to information technology, institutions to help enhance trade and development, comprehensive regional economic partnership, and a crisis management system of currency swaps. These were not developed to undermine the West. The currency swap system simply underwrote an expansion of the Shangri-La currency system developed by Japan and Southeast Asian countries after failures by the US and the IMF in the Asian financial crisis. The initial BRI institution, the Asia Infrastructure Investment Bank, was carefully designed to be compatible and complementary with the Asian Development Bank and the World Bank. Jin Liqun, its first leader, was chosen because he was an idealistic alumnus of both the World Bank and the ADB. But the US responded by denouncing the AIIB, saying it would use low standards unless other countries stayed out and pressured China, and it urged its allies to reject it. Other countries did the homework that the Obama administration failed to do and realized the value of the new institution. 103 countries, including most of US allies, joined, and AIIB performance has justified their decisions. A high proportion of AIIB projects are joint with the World Bank or ADB and therefore meet their standards. At the time, this was typical of much Chinese policy. The early reformist Chinese leaders admired Western markets and even much of Western politics as models for emulation. They sought to join the system. China sought to contribute more to the World Bank and IMF, but the US Congress preferred to hobble those institutions rather than accept more Chinese influence. China sought negotiations to limit weaponry in space but was told to buzz off. The US was going to rule in space and wasn't going to accept Chinese intrusions. China has been a big contributor to the UN, including the largest contributor of peacekeeping troops. By all accounts, that true contribution has been constructive. US attitude is pretty constructive. Chinese membership in Western institutions was fine, as long as they didn't get uppity. They were not allowed to be full proportionate members. If the Chinese formed institutions that are compatible with Bretton Woods, like the AIIB, Washington would try to hobble them. The US not only sought to limit China's institutional roles. It allowed its own successful institutions to deteriorate. The World Bank, IMF, and ADB were held back by congressional stinginess. After the Mexican crisis in 1994, Congress forbade the kind of successful rescue the treasury had conducted, even though the rescue cost the US nothing, that hobbled the US response to allies, Thailand, and Indonesia in the Asian financial crisis. That, in turn, create a vacuum. Japan and us in trying to fill the vacuum first with the Japanese version of the IMF, which Washington quashed, and then with the Shangri-La currency swap system. A \$12 trillion gap in infrastructure funding emerged, and China started to move into these vacuums. At the same time, China became disillusioned with Western models. The global financial crisis and the rise of Donald Trump and Boris Johnson convinced a large part of the Chinese establishment that Western models were too vulnerable

to instability and irrationality. On the other side, the more repressive Hu Jintao government, the extremely repressive Xi Jinping government, China's maritime overreach, and China's obsolete assertion of developing country privileges alienated the West. The two systems started spinning into a more hostile relationship. What China has grasped is the lesson of America's Cold War victory. Geoeconomics is the key to leadership, and Bretton Woods-type institutions are the key to international economic leadership. When China focuses on creating a circle of development in Africa while the US focuses on providing special forces teams in an offshore naval presence, China wins every time. The biggest source of US influence in Africa has been George W. Bush's HIV prevention program. The US has forgotten the lesson it taught the world. The US needs to remember that lesson, restore economics to the center of US policy. And the US should compete with China on belt and road projects but also celebrate every development success of belt and road. Every country that is stabilized can save the US a trillion dollars in antiterrorism expenses. The mostly bipartisan myths that I've talked about harm Americans economically, and they lead gratuitously toward a risk of economic war or shooting war. If China seeks to militarize the Philippine territory at Scarborough Shoal, let us prepare to fight. If China threatens freedom of the seas, we must fight. When predatory Chinese practices threaten Western economies, as happened with Huawei's 5G, we must ban their wall ways. When Chinese abuse of Uighurs in Xinjiang makes them moral pariahs, let America lead the denunciations. But we still need to engage with China on climate change, the environment, nonproliferation, Korean peace, terrorism, piracy, space, economic development programs, global financial stability, and the need of American companies to access the China market. The world is complex, and US policies have to be complex. If we want peace, if we want prosperity, the fundamental issues are two. The US must accept China as an equal in all major institutions and in all major global decisions. Conversely, China is no longer a developing power. It needs to act like the mature world leader it's claiming to be. It can't be an accepted leader while claiming obsolete developing country privileges or nursing grudges for a long ago century of weakness or taking advantage of its smaller neighbors. These things are easy to say. They are very difficult challenges for both countries. Let me stop there. Thank you.

- Thank you, Bill. That was a very provocative and interesting talk. Let me, at the outset, put this question to you and ask Winnie if you could signal me how I'm to handle questions from the audience in general, perhaps by telling me on the chat. But Bill, with the various myths, various misconceptions, you've been, I'm sure, following the things that Vice President Biden said during the campaign. You followed what people close to him have said. If you had to identify what from your perspective is the direction of error they're most likely to fall into of the various ways in which they could deviate from your advice, what mistake are you most worried United States will

make in the next nine months?

- Well, first of all, I think we're headed toward a much more systematic, professional, technocratically decided policy toward China. I think the two biggest mistakes are, first of all, the ideological one that says engagement with China was a terrible mistake because the predominant reason for it was to democratize China or to turn it into a liberal Western society, depending on who's appointed to the key positions and depending on the candidate's willingness to refute that because that's been become a very widespread view that could end up enhancing a kind of McCarthyism and a kind of ideological anti-China obsession. I think that's not the vice president's instinct, but it's got so much momentum that he needs to get it under control right away. I think that the second thing is that the vice president may have a very balanced, calculated view of, I should say the president-elect, may have a very balanced technocratic view of the trade relationship with China. But his party, and that includes both what I'd call the manufacturing union, reactionary like Nancy Pelosi and the progressives, are committed to this erroneous view that most of the problem of lost manufacturing jobs is due to China, and they're absolutely determined to prevent our joining the CPTPP or any other expanded trade relationship. And that's gonna leave us isolated. We're gonna have a disadvantage compared with most of the other countries of the world. If the president-elect is courageous, he will stand up and announce a very ambitious program for helping American workers and start moving it back toward a more balanced view of our trade and investment relationships. At the Fairbank Center a week ago, Jeff Bader said, "That's impossible," and he's an important incisive voice. I think he's probably right. So we're gonna have a problem.

- I published a memo yesterday with advice on the broad international environment to the new treasury secretary, whoever that might be, which I advised, not with any pleasure, that the political capital expenditure involved in relaunching TPP and the risk that we would again damage US credibility by not being able to get it through were sufficiently great that, until we had established more credibility, our international economic policies were not driven by elite concerns, that it was a mistake to undertake a TPP, not that if you gave me my choice. I wouldn't decide up or down, but a prudent president knows that he can't pursue all things he thinks are good or even most things he thinks are good. How costly do you think in terms of our relationship with China it will be if we don't pursue a TPP? I have to say my fairly confident view is that the impact on US middle income wages 10 years from now is extremely unlikely to be as high 1% from the passage of TPP. [indistinct]

- I'm not sure I understand completely but if we don't pursue CPTPP, we lose economically in our relationship with the non-Chinese Asian countries. And I suspect some version of China's CREP, Comprehensive Regional Economic Partnership, will happen, and we'll be left out of

that. I think your sense of the cost of that is far more refined than mine. I'm absolutely sure it is. But I can also see us getting relatively isolated a lot in a number of key industries being significantly harmed, and I can see it's getting into a spiral where other countries are following a more rational, economically rational policy. So I think there are quite significant long-term risks. If I were in your position or Jeff Bader's position, advising the new administration, I would say exactly what you said. If you try to open up a new trade liberalization relationship, you run into a brick wall, you lose capital domestically, and, as you said, you lose credibility internationally. But I think what's necessary is to begin this process of explaining to Americans and explaining to the president-elect's fellow Democrats the realities of what causes our social problem and what it's gonna take to deal with that social problem, because helping these people is gonna be enormously expensive. But not helping them is gonna be far more expensive. We're gonna get a much worse Trump the next time around. The fall off in Americans' support for democracy is quite dramatic. And people still express shock that Trump doesn't follow democratic norms. That's because a very high proportion of his constituents don't care about democratic norms, and that proportion is gonna get much higher, and that means the next version is gonna be able to trample on democracy much more. So this is a long-term building process that really involves reorganizing the Democratic party, and the thinking is driven by the constituents. It's not that they haven't read the feature articles in the "Wall Street Journal" and the "Washington Post" and the "New York Times" about all the research that shows the very small minority of the lost manufacturing jobs are due to China. It's available. But somebody who cares about the country has to think, "How do we do the kind of reorganization that FDR did to meet an earlier crisis?" This is a great crisis of our democracy, and the president-elect is gonna get all wound up in this week's issues and this year's issues. But what our country needs is to figure out how to get US back on track domestically so we can then get back on track internationally. Larry, I think people would like to hear a lot more of your thoughts.

- Well, it's your seminar, Bill, so I'll be very brief. I think you are entirely correct in your view that the trade deficit is a kind of ludicrous statistic for evaluating what's happening. I think you are entirely correct in your emphasis on the fact that manufacturing is well thought of as going through a process, much like agriculture did. I think that the insight has not fully permeated that manufacturing completed that process 60 years ago or had largely completed that process 60 years ago, and agricultural support programs of one kind or other are a substantial component to the federal budget, even today. And what that means and the concept of support for a industry that's declining in employment and ability to provide livelihood by virtue of success and what the depression-era agricultural programs' counterparts for manufacturing, it seems to me, is not a question we've quite been willing to pose because to too many people, it seems

inappropriately defeatist, and I agree with you about doing something about that is important if we're gonna maintain a rational foreign policy. I think that there's been a problem. This is why I reacted to your comments on TPP, that people have seen the efforts as manufacturing support as being motivated not by caring about the substantial number of our fellow citizens whose lives are being very substantially disrupted, but instead as paying off a constituency so we can get our trade agreements with our intellectual property rights for elites and that demonstrating the sincerity of our conviction rather than the linkage of our conviction to our desire to carry on elite projects is enormously important to success. And that's why I think the vice president's position, which is we're gonna take a bit of a break from new trade diplomacy until we figured out some of the domestic issues is something that I think is very much right. I think the points you made about consumer interests are very much correct, and it's always true in trade that because the producer interests are so much easier to organize than the consumer interests, the producer interests often are able to get a disproportionate weight. I think your distinctions between the threats posed by Nazi Germany or Stalin's Russia and the threats posed by China and the distinctions you draw between 'em are very much appropriate, and I would add the point that I think there is a reasonably strong case to be made that in excessively Cold War spirit, these of the Soviet Union that had come to be our policy by the late 1950s, had some substantially adverse consequences. If John Kennedy hadn't declared a massive missile gap and a major effort to build up missiles, would Khrushchev have decided to put the entire world at risk by putting missiles into Cuba? I'm not altogether certain. I think we have learned the lesson that weakness begets aggression rather more securely than we have learned the lesson that truculence encourages truculent responses. And one could say the same thing about the mentality that led US into Vietnam came from excesses of the Cold War mentality. So I would argue both that the Cold War comparison is unwarranted and that, with the benefit of hindsight, there are aspects of our Cold War strategy that were a bit more warlike than would have been ideal. We won basically because of our domestic strength, self confidence, resilience, and ability to correct as problems emanated more than we won because of our determination to confront. So your pleas for pragmatism struck me as very much appropriate. A question that seems to me enormously important where I do not yet have a line that I'm confident I will hold for a long period of time 'cause I find myself changing my mind is to what, if any extent, is it appropriate to use the Chinese challenge as a means of pushing forth desirable domestic objectives? The Cold War was used to promote the interstate highway system. It was used to promote the federal role in education. It was used crucially to promote what were seminal and very good federal funding of higher education and federal funding of scientific research in particular. To go back and read the civil rights dialogues of the late 50s and early 60s, the need to not have racist Southern governors disgrace the United States with what they did on newsreels projected around the

world clearly figures in the motivation of figures like Lyndon Johnson or John Kennedy, and I could go on with those examples. And it seems to me there is a question which is at a moment when the country is extraordinarily polarized, a moment when, beyond the polarization of the country into factions, there are clearly concerns with what some people call identity politics, people who are more identified with their group than they are identified with their country. And there is a sense of a fissure of the public. The appeal of pointing to a common external challenge as a way of spurring desirable and necessary actions and bringing about unity is immensely attractive. And yet it seems to me that it runs the risk of whipping up paranoid nationalist fervor in ways that the whippers might not be able to fully control and in a way that could be very easily misinterpreted abroad. And so I find myself as I go around and talking in different places, using formulations about the need to maintain the power of the American example at a time when the viability of democracy is increasingly challenged, and so raising the specter in a way that's not put in terms of we need to win against our adversary. And then I say to myself, "Is that a perceptive nuanced way of drawing the energy without being provocative, or is that just too cute by half, and this is bad business and basically jingoist, and it's the job of people like me to discourage all this kind of stuff rather than to encourage it?" And then I see the difficulty of mobilizing around it, and so I'd be interested in your thoughts. But it seems to me there is a question as to what the broader political resonance is and how one tries to have the China relationship figure in a broader political context in the 93 different versions that everyone who wants to be the next George Kennan, rivalry partnership, co-opetition, competition with cooperation. Everybody's got their phrase for we need to have confrontation in some places and cooperation in other places and lots of dialogue. Everybody has a phrase for that, and it's right. It's platitudinous and doesn't help with individual decisions, and it's also not a framing that 310 of the 330 million Americans will ever notice. And so that those questions around the broader framing seem to me to be very important, and I'd be interested in any thoughts you have or that Ezra has.

- Now let me comment briefly on that and then turn it to Ezra. I think you identified an absolutely pivotal issue. On the one hand, paranoia about China has become extreme in many places in the US, and we can't afford to whip it up more. There have been a rash of hate crimes against ethnic Chinese. A couple of weeks ago, a Japanese musician got off the subway in Harlem, and a bunch of people called him an expletive deleted Chinese and beat him up so badly that he may never be able to play music again. We can't afford to whip that up anymore. At the same time, I have a very limited idea about one aspect of your question. If we can point to the scientific and technological challenge of China Sputnik moment and get that to restore some of the funding for science and technology and for education in that area and maybe at the same time point out our reliance on Chinese and ethnic

Chinese scientists and businessmen in that area, maybe we can get people excited to do something in a focused area without becoming generally paranoid. The superiority of Alibaba and Tencent to what we have, superior wiring of countries, South Korea, China, Japan, compared to ours is something we might be able to get people excited about without creating racist paranoia. So that's just a limited thought, but Ezra has some thoughts. Ezra, you're on mute, so you need to unmute.

- You're muted, Ezra.

- You're muted. Yeah, there you go.

- I was gonna try to relate this to the China issue, which is where I come in, and I think both what Bill and Larry had been saying is extremely important. And because what we can do, I would like to advocate policy that gets us to work well with China, but that depends on our domestic base of how much we can move. To Larry's comment about how we might use what China's doing to affect America. What I'm afraid is that it will end up pushing us to have more military because the military is very poised to have new equipment and can use the threat, and the other is, I'm afraid, that right now it will push us into complaining more about their basic system with the Uighurs in Hong Kong and all the questions about human rights, and to me, pushing China on that is only gonna be counterproductive. If we wanna have progress and working with China together on global issues, that's only gonna make it more difficult because they're so concerned about allowing more voices in China, and they would see this as a threat to their providing stability, so they would react in a very bad way. So that's what concerns me about how these might affect what China does. But the question I would like to ask, it's taking your basic point, but one of your basic points that it's not industry. Industry is dead. The question is the service sector. So I would like to know for Bill and to Larry, to comment on what the United States could do in the service sector or to stimulate the economy, what we could do to remove some of the base of, say, the poorly educated whites in the red states who are so pro Trump and so upset, what we could do to make the American economy a more balanced economy, give those people more hope so that we wouldn't have to dump on China.

- Larry, you wanna comment on that?

- That is the very large question, and I think there's some things that most economists would agree on. Most economists would agree that putting more emphasis on maintaining strong demand in a Keynesian way relative to fighting the specter of inflation makes a very large difference and probably makes a larger for people who are disadvantaged than for people who are advantaged. And that's why you see a lot of emphasis on public investments and you see rather a change in attitudes towards budget deficits. I have been a strong

advocate of regional policy. One of the less remarked changes in the American economy is that it used to be true that there was a fairly strong tendency towards convergence. Rich places tended to fade over the subsequent two decades. Poor places tended to rise over the subsequent two decades. Since sometime in the early 80s, that has not been the case. The coastal elite cities, including the one in which we live, have basically pulled away. They basically become rich knowledge centers with heavy fractions of college graduates. Other people have been forced to leave by high housing prices. Other places have lacked critical nucleus around which to organize. We've had very little in the way of conscious regional policy. What is a modern-day TVA for the Rust Belt seems to me to be a question that should be getting much, much more attention than it receives on a regular basis. To what extent can we usefully strengthen incentives to hire in relatively high unemployment areas? There are various ideas which I'm sympathetic to for employer-side measures like measures to complement the earned income tax credit. But I think the thing that has to be said that is hard is that the current state of social science is not particularly good at predicting or controlling macro social trends. To take a positive example, the crime rate in America, the murder rate in major American cities today, even with the problems in the last couple of years, is about a 1/7 or 1/8 of what it was 30 or 40 years ago. I could tell you about community policing and a few other things, but it's not that anybody 30 or 40 years ago would have said they had a plan that would reduce it to anything like 1/6 of its previous level. There are less happy trends around the fraction amount of wedlock children that people have difficulty predicting. So the question that you have in mind of this group of people who might once have had a job on a factory floor and now seem in a very, very bad way is a growing, festering problem. There's a longer program that I could envision, but it's not that I'm confident that that program would be highly effective. But what I know is that the magnitude of the changes that take place tend to seem large relative to the programs that we launch. I do think that, to use Roosevelt's famous phrase, "bold persistent experimentation," and we should try things that, if they don't work, we should try other things. I think a sense of insistence around seeing what's happening in these areas as a problem is a very serious one.

- I would just say that I agree that our ability to predict is extremely limited. To my mind, the Asian experience is that trying and getting it partly right and partly wrong and doing course adjustments is so much more efficient than what American societies have tended to do recently, which is to let the market take care of it. Park Geun-hye started doing economic and social planning in Korea. None of the numbers very accurate sense of what was gonna happen in the future, was a bit of a dart throw, but they gave it their best shot. And I see every year doing projections of this is where jobs will be lost, and this is where jobs will be short. And what if we nationalized that part of McKinsey and try tried things and did course correction? That

comes back to what you were saying about radical experimentation. Just puts a little extra emphasis on the value of trying the planning exercise. I used to go to Taiwan, and they had a one-year plan, a three-year plan, a five-year plan, a 10-year plan, and a 30-year plan, and oil prices would go up, and all the plans would be changed. They always knew that next year, all the plans were gonna be changed. And I don't advocate having that degree of planning, anything like it, but our society has moved so far in the opposite direction of you never plan, you never project that I hope we can move back a ways in the other direction.

- We have received quite a number of questions from the audience. Since we only have a few minutes left, let me see if we can take at least one question. It's a question from Deborah Broughtingham, and her question is, "One of the US-China conflict is over the existing rules for transparency and management of official lending, especially export credits and debt relief, and the United States has mostly been relying on informal rules, such as the gentleman's agreement on supported export credits." So her question to you, Bill is, "How should the US move forward in meeting these challenges?"

- Well, first of all, I'd start from a broad perspective that heavily drawn from her research that a lot of the BRI lending and projects have been a very good thing for the countries involved, and so I put a positive aura around it. And then I'd press very hard for the transparency on the grounds that ultimately, this is good for China, that they need to know what the country's total debt burden is. They need to know all the details. They need to have their institutions share the details with other Chinese institutions, which is a kind of transparency that we don't necessarily think about. But again, this reminds me of dealing with the Japanese 40 years ago or two years ago, by making this a negotiation about what's in our mutual interest and specifically in their interests, too. We can gradually move forward. It's not gonna be solved overnight, but a guy who worked for a bank, the Chinese banks need this probably more than we do. And so there's a foundation for moving in the right direction at a reasonable speed, but it's not gonna happen if it's done in the context of Assistant Secretary's Stilwell saying, "You guys are kind of trying to create a debt trap, and everything you're trying to do is bad for the world." No, here's a problem that the Chinese banks, along with the French banks and the American banks, need to solve, and the lesson of history is that if we work together and share information, we all end up better off.

- So thank you very much. I wanna thank Bill and Larry for a very informative, insightful discussion. It is very timely, obviously. In the coming months, I think that things will continue to unfold, and there are lots of questions. And because this is such an important topic, and if you're willing, we can send these questions to you, Bill, and you might wanna respond to the participants. There are like

over 20 questions on the screen, but we didn't have time to get to it. So once again, on behalf of the Fairbank Center, I thank you for a wonderful seminar, and we look forward to further conversation with both of you. Bye bye.

- Thank you, Winnie, and thank you especially, Bill. That was really very, very insightful, Bill. Thank you.

- Thank you.

- Bye bye.

- Bye bye.