

Transcript

Is China Finally Overtaking the United States?

Professor Joseph S Nye

University Distinguished Service Professor, Harvard Kennedy School of Government

Chair: Gideon Rachman

Chief Foreign Affairs Commentator, *Financial Times*

9 Jun 2015

The views expressed in this document are the sole responsibility of the speaker[inaudible s] and participants do not necessarily reflect the view of Chatham House, its staff, associates or Council. Chatham House is independent and owes no allegiance to any government or to any political body. It does not take institutional positions on policy issues. This document is issued on the understanding that if any extract is used, the author[inaudible s]/ speaker[inaudible s] and Chatham House should be credited, preferably with the date of the publication or details of the event. Where this document refers to or reports statements made by speakers at an event every effort has been made to provide a fair representation of their views and opinions. The published text of speeches and presentations may differ from delivery.

10 St James's Square, London SW1Y 4LE T +44 [inaudible o]20 7957 5700 F +44 [inaudible o]20 7957 5710
www.chathamhouse.org

Patron: Her Majesty The Queen Chairman: Stuart Popham QC Director: Dr Robin Niblett Charity Registration Number: 208223

Gideon Rachman

Well good evening everybody, and welcome. I think it's a testament to our speaker tonight to see just how packed the room is. I've had the pleasure of seeing Joe Nye speak on a number of occasions and in a number of cities and he is always worth listening to. Joe, I just took the precaution of checking a fact on Wikipedia, Joe did indeed join the faculty of Harvard University back in 1964 and has made many major contributions to the study of international relations ever since. Working on independence theory, giving the world the phrase soft power and the thinking behind it.

He's also one of those, in the great American tradition, a scholar-practitioner, somebody who's worked at Harvard, but also working in government at various times, in the National Security Council and in the Pentagon. And I remember saying I have seen you perform a few times and seen you at Ditchley in 1994-95 and I think you were at the Pentagon at the time when the Taiwan Strait crisis was just taking place. So he's really been at the centre of this whole question of the rise of China and what it means for the world and China's relationship with the United States.

His book over there is about the perennial question of American decline, is happening or isn't it and Joe has consistently been on the anti-decline of school. He wrote in, I think it was 1992, a book called *Bound to Lead* which correctly, took on the idea that Japan was about to take over the world. He is now seen off Japan and is about to deal with the next challenger, China, which is the subject of tonight's talk, so Joe can I welcome you to the podium.

Professor Joseph S Nye

Thank you very much. Good evening. It's a pleasure to be back at Chatham House. It reminds me that once upon a time I was actually a research affiliate here at Chatham House and my wife Molly and I lived here, it was a wonderful place then and it still remains a wonderful place. So it's nice to be back and I appreciate Gideon's kind introduction. I should say that I'm going to start though on the question that we're addressing tonight – is China overtaking the United States? – by disagreeing with my favourite newspaper, the *FT*. I read it, I not only read it, I even pay for it, but even the *FT* can, if not be wrong, can perhaps not get things exactly right. By that I mean if we're looking at this issue of has China overtaken the US.

Some of you may remember an *FT* front page headline about a year ago, maybe a little over a year ago, saying China is now the world's largest economy and that was coupled with a general view many people expressed that the 21st century was the Chinese century. And that this was the, this basically was the turning point. Indeed, perhaps that view which was expressed by my colleague at Harvard, Neil Ferguson who is calling the 21st century as the Chinese century, has been perhaps put more dramatically in the title of a book by Martin Jacques called *When China Rules The World*. So if we believe my favourite newspaper, we're there, or just about to be there.

The fact is reinforced by a poll that was taken recently in the United States that people were asked about China and the US and half of the American people thought that China had already passed, or would soon pass the United States. So looks like the evidence is

pretty strong for that approach. I would submit that, first of all, one should not pay much attention to polls of this sort. Primarily because Americans are very strange people and they've always been worried about their decline. Right from the start, if you look at, you know, the Puritans who broke away from the Church of England and went to frigid and frozen Massachusetts to set up their church, always were worried whether they'd live up to the standards of purity which had led them to reject the old world.

And the founding fathers in the United States, Washington and Jefferson and so forth, they were always worried about decline. For them it was decline of republican virtues because they were trying to create a new form of government, which was a republican government when the model that was standard was monarchy. And so they looked to Rome, but not to the decline of the Roman Empire, but the decline of the Roman Republic and they kept fearing that they were losing their republican virtue. And in the post-World War II period, there'd been a series of opinion swings in which there's been this rise of decline – as if that's not an oxymoronic phrase.

In 1957, when the Soviets put up Sputnik, there was a view that the Soviets were 10 feet tall and then in the 1980s when Japan's manufacturing model proved superior to the American manufacturing model, or at least the Roosevelt version of it, colleagues of mine wrote books called *Japan Is Number One* and the Japanese were 10 feet tall and then in the aftermath of the great recession of 2008 it was China who with massive stimulus program was growing at 10 per cent a year and the American economy was in the doldrums, the Chinese were 10 feet tall.

I would submit to you that all these swings of opinion and polls are not much of use for anything except telling you something about the strange nature of American psychology, but in terms of understanding realities of power relations of the world, you have to look at something more serious than that. And that brings me to this question of whether there are trends in the United States which represent decline and then trends in China which means that China has indeed passed the United States.

On the first, the question of what is actually happening to the United States in terms of decline, it's useful to distinguish two dimensions of decline. One is absolute decline and the other is relative decline. Absolute decline is what happened to ancient Rome. If you look at Rome, it didn't decline because of the rise of another empire, it wasn't the Persians or somebody who overtook them, it really was the result of the internecine warfare and the inability to develop an economy with internal productivity. If you wanted to get rich you had to go conquer somebody, you didn't have a technology which led to productivity, which led to autonomous internal growth. And in that circumstance Rome was unable to defend itself against hordes of barbarians. Essentially it was a country in absolute decline.

Now, it's also worth noticing it took about three centuries to go from Trajan to 476, even more, 3 and a half centuries, so it didn't happen overnight, but the point is that was not a rivalry with another empire, it was absolute decline. It is popular among some editorial writers and op-ed writers to have a clever heading to try to get your piece accepted in one of the finer papers to say America is like Rome, you know, if you look at the gridlock in Washington, if you look at the problems of the growing inequality, if you look at the difficulties of K to 12 education, this is the, America is in absolute decline. It's a nice way to put a headline on a piece, but it's also very inaccurate rendition of history.

I would argue that there are a number of trends in the American economy and society, which make that a poor metaphor, or a poor use of historical analogy. Start with demography. If you look at population, today the most populous country in the world is of course China, followed by India and third place is the United States. If you look at the projections by the United Nations demographers it will be, in 2050, India, China and in third place, the United States. Most remarkable that is not the reverse of India and China, it's that the Americans maintain that position because no other large rich country is going to have that. All the other large, rich countries are going to have declining populations and if you look at Europe, if you look at Russia, if you look at Japan, they're all going to see not only demographic decline, but changes in the structure of their population by age.

So you're going to have fewer young productive workers helping to support more older, dependent people. Except in the United States where, in fact, you're going to have a demographic structure, which is more balanced, largely because the Americans remain a nation of immigration. Now, you might say, but won't that change? I don't think so. Americans have always complained about immigration. You know, in the 19th century, we had a party called the Know Nothing party, which was founded in opposition to Irish Catholics who were destroying the country, but within a century we elected an Irish Catholic president. So the fact that we have an anti-immigrant complaining, doesn't mean that we're going to stop immigration, is that we don't stop immigration, then America will in demographic trends be healthier than many others, including China incidentally, which has now reached a peak in its population of the Chinese labour force has probably peaked this year.

So the structure of the Chinese population by age is going to be changing. If you take a second trend in terms of where the United States is, think about the energy revolution. If we were here at Chatham house a decade ago, we would be moaning at the fact that American power was being undermined by constantly increasing dependence on imported oil, particularly from the Middle East.

Today, the IEA in Paris projects that North America may not be importing energy in the 2020s. That's extraordinary and it's the result of the so-called shale revolution in which the technology of hydraulic fracturing and horizontal drilling has unleashed massive amounts of oil and gas, that were always there, but it was the technology and the entrepreneurship of the capital structure property rights, which essentially made this change.

Or if you take a third trend, look at the key technologies of the 21st century, it's often said that the most important technologies of this century will probably be biotechnology, nanotechnology and the third wave of information technology. If you ask what country is at the forefront of all three of those, it's the United States and underlying this is the structure of higher education. Which, if you look at the ranking, there are lots of rankings of universities, but let's take one by the Chinese, the Shanghai Jiao Tong University has said that of the 20 most important or best universities in the world, 15 of the 20 are American, none is Chinese.

So, comparisons to ancient Rome or absolute decline just strike me as off the track, in other words it's a clever headline, but it doesn't fit the types of facts that I just described. On the other hand, if you look at something else, which is what we might call relative

decline, then there is something that's changing and relative decline can be seen as just that, or it can be called the rise of the rest. So it can be the rise of China, India, Brazil, Indonesia and others in terms of as they do better, their share of the world economy increases. So in that sense, if you look at, back historically the United States entered the 20th century with about a quarter of the world economy, that goes up to nearly half the world economy in the aftermath of World War II, when Europe and others had been laid low by the war and the Americans had strengthened, it declines back to about a quarter of the world economy in 1970 and the Americans end the century at about 23 per cent of the world economy. Which is interesting, because if you then ask where will we go next, the IMF projections are, they probably will be going down to something in the range of 17 or 18 per cent.

Some declined because of the rise of others, but not an absolute decline. It's interesting how you term this and how you force it, not force it but how you frame it. Because Henry Kissinger and Richard Nixon who had been among the most perspicacious of our statement in terms of understanding the rest of the world, believed in 1970 that the United States was in decline and they didn't distinguish absolute and relative decline. Both of them thought and said and wrote, the world is multipolar. Of course, that wasn't the way it turned out. The century ended with uni-polarity, not multi-polarity.

So how could such wise men have gotten it so wrong? Well, what they did, is they looked at a straight line and extrapolated it without changes. So if the United States was nearly half the world economy in 1945 and was back to 25 per cent in 1970, they thought, well the lines are going to keep going, they mistook a relative decline for absolute decline and in fact, what happened instead was, we had returned to the main or returned to the average and ended the century basically where we began it.

So that's a caution against overdoing relative decline. There will be relative decline, but we shouldn't mix it up with absolute decline and if you take a straight line and extrapolate it, you're rarely going to be right in history, history is always full of bumps and curves with kinks and so forth, but that's an interesting illustration.

So that's my picture of the United States. Problems? Yes. We have lots of them and always have had. Absolute decline? No. Relative decline? Yes. But don't mistake it for something which is as debilitating as Nixon and Kissinger thought, as they portrayed it in the middle, or late part of the last century.

Now, how about China? Let me come back to my somewhat snide comment about the *FT*. The *FT* headline was fine, in terms it wasn't inaccurate, but it was based on purchasing power parity. Now purchasing power parity is a measure that economists use to compare welfare in different societies and is very useful for that, but when you're talking about power internationally, you don't import oil or jet engines in purchasing power parity, you import it at the exchange rate and at the exchange rate, the Chinese did not pass the United States in the last year. So, it wasn't that the headline was wrong, it was misleading, but that's a headline writer, not a columnist. Well, it was the IMF, but how you portrayed the headline was, but anyway, I'm just teasing, Gideon, but the point is that at some point you could expect that China will indeed be larger than the US economy in terms of aggregate GDP measured in exchange rate.

The question of when that will be depends on the numbers that you use for Chinese growth. You have 1.3 billion people growing at 10 per cent, and 350 million people growing at two to three per cent, obviously those lines are going to cross when will they cross? Well, nobody really knows. *The Economist*, and other, I always seem to read British journals, but another thing I rely on, like I rely on the *FT*, they had a time when they were speculating that it could be as early as 2019. Now most people think that that's more likely to be somewhere after 2030.

Charlie Wolf at Rand, an economist at Rand actually says 2040, but the point is that when you think these lines will cross over, it depends on what you insert as a Chinese growth rate. China was growing at 10 per cent for a long time and, wonderful achievement for China. They'd raised hundreds of millions of people out of poverty and they deserve full marks for what they've done, but it's also true that now Li Keqiang, the Prime Minister talks about seven per cent growth as the new normal and my colleagues at Harvard, Larry Summers and Lant Pritchard have just done a study in which they look at other countries which have historically grown at double-digits. Remember Japan once grew over 10 per cent a year and said what would you expect as a regression to the mean or a return to the average for China and they said, 'It's more likely that you'll see Chinese growth at about 3.9 per cent.'

Well depending on what number you plug in as you extrapolate this curve, you can pick the date that you think China will be larger than the US. But let's pick a day out of the air, I'll pick 2030, just, which is the date that I think is a conservative date, but where China might be or probably will be larger than the US as an economy overall. Does that mean that China's economically more powerful than the US? Well, not necessarily, but what it does mean is that China will have a lot of economic power, it does today already from having a large economy, that not only gives you access to a major market, which you control for political purposes due to a large economic base on which to grow your military which the Chinese have been doing at over 10 per cent a year.

So, I'm not belittling the importance of economic size overall as a factor of economic power, but it's not the only measure of economic power. I wrote a book a few years ago called *The Future of Power*, trying to point out that there are many dimensions of power and we sometimes make mistakes by oversimplifying it. So if you think about whether the Chinese economy will be economically more powerful than the US, you should also ask about the sophistication of the economy and you make a case that there's more to be learnt about sophistication in an economy, not by looking at absolute size, but by per capita income and in per capita income, the United States is about four times China and when China, let's say that China passes the US in overall size in 2030, get my number picked out of the air, even at that time China will probably less than half of the US in per capita income.

Now, what does that mean, sophistication of an economy? Well, it can mean a number of things, we can go into them more in the question period if you want, but perhaps the easiest way to think about it is that when China passed Germany as the world's largest trading country in 2012, that was a major accomplishment, it gave China a good deal of power as a result of that, but it's also true that it can be misleading to just look at that headline figure. So if you take something like this device, which many of you are carrying, this is an Apple iPhone, it costs about \$750 in the US, it's an import from China, but how

much of the value added of this is Chinese? About five per cent. If the components come from other countries, Chinese labour puts them together, intellectual property comes from the United States and the marketing basically is American.

So you can be misled by a headline figure in terms of thinking that there's more sophistication there than there is. Or is Chinese sometimes put it, they've been much better at producing jobs than Steve Jobs. Now, this will change and it is changing but nonetheless the point that I'm trying to make is don't jump the gun by saying that when you have something which is an aggregate number, that it gives you a real measure, or the only measure of economic power. If you think of power generally, there are three dimensions. If power has the ability to affect others to get what you want, it can be done by coercion or by payment, or by attraction, what I call soft power. In coercion I think you can make a case that China will come closer to the United States in military power, but I doubt that it's going to pass it in the next quarter century. The Americans are still four times the Chinese military budget.

Now China's budget is growing rapidly as I mentioned earlier, but to catch up to the Americans on a global capacity to project power, I think it's unlikely. Chinese naval capacity and the areas of its coast are growing mildly, and that can lead to disputes and problems as we've seen in the recent headlines about the islands and the atolls in the South China Sea. But I think it's more likely they are going to see a situation where globally it will be the American Navy and American military power that is crucial, so they're thinking this in terms of China's interest. China will be importing more oil from the Middle East and its naval capacity will help perhaps protect the sea lines to the Straits of Malacca in their own region, but I suspect the Straits of Hormuz will still depend very heavily on the American Navy.

So military power I don't see them passing the US and then if you look at soft power, this ability to attract and get what you want through attraction rather than coercion or payment, China has invested a lot in soft power and that's a smart strategy. Because if your hard power is growing, you're likely to frighten your neighbours and form coalitions against you, but if you can combine it with soft power of attraction, those coalitions are less likely to be effective. So China is making major efforts, spending billions of dollars on it with Confucius Institutes and turning China Central Television into a 24/7 broadcaster and so forth. But they have two problems which we can see if you look at public opinion polls, how China is doing with soft power, not as well as their investments would suggest.

One problem is that they tend to think that the government can generate soft power, whereas most soft power, let's say in Britain or the United States, really is generated by civil society. It's the universities, the entertainment industries and so forth, and the other problem that China faces is that it has territorial disputes with many of its neighbours and given arising climate of nationalism, that territorial disputation tends to create resentment. And another way of putting that, it's all very good to set up the Confucius Institute in Manila in the Philippines, to make traditional Chinese culture look attractive and traditional Chinese culture is attractive, but if Chinese naval ships are at the same time chasing Philippine fishing boats out of the Scarborough shoal, which Philippines say is in their exclusive economic zone, that doesn't mean your Confucius Institute is likely to produce much soft power in Manila.

So, on all three dimensions, economic military and soft power, I don't see the Chinese replacing the US as the most powerful country by, well let's say a quarter of a century from now. I don't make a projection for the end of the century because I won't be around to check it, but in any case, I will just limit myself to this, the next quarter of a century. In any case, to conclude this, so we can get to Q&A, you can ask yourself so what? Why does it matter? I think it matters for two reasons, not for bragging rights, in some ways you can say who cares who's number one, but it matters that we have accurate assessments of power relations because that often drives policy choices, which can be better and worse.

It's often said that when you have a rising power and an established power, that that creates conditions which lead to conflict. So this was Thucydides' famous explanation of the Peloponnesian War, that it was caused by the rise in power of Athens and the fear created in Sparta and many people attribute World War I when the European system tore itself apart to the rise in the power of Germany and the fear it created in Britain, a great oversimplification I should say.

But the point that I think is important is some people are claiming that this century, the 21st century will see the rise in the power of China, creating fear in the United States, which will lead to a great conflagration and, for example, John Mearsheimer, a distinguished political scientist at the University of Chicago has stated flat out that China cannot rise peacefully. I disagree with that and I think the historical analogy is wrong because in 1900, Germany had already passed Britain in industrial strength. So, well before 1914.

If you believe the figures I've given you, but that are supported in the book in greater detail, China is not about to pass the US, if that's true then we don't have to succumb to fear. We have more time to manage this relationship. There will be conflicts, there will be competition, there'll be competitions as there are in many relationships, but they don't have to give rise to this kind of grand conflagration that the pessimists describe and the other reason why it's important is the same time that the US and China should not give in to belief that conflict is inevitable, there are going to be some areas where new transnational issues are going to require US and Chinese cooperation.

Not just US and China, with Europe and other countries as well, but if you think of climate change, that can't be solved by any country acting alone and if you think of transnational terrorism, no one country can solve it. If you think of cybercrime, no one country could solve it and if you think of pandemics, no one country can solve them, there are going to be more and more transnational issues, which don't succumb to the easy clichés about multi-polarity, unique polarity and so forth. There are no polarities and the only way to deal with them is essentially with cooperation.

So if we're thinking too much about China as a threat and focusing only on that, we may fail to engage in this type of cooperative action that we need and that since I say in the book, I'm more worried about entropy, the inability to get work done collectively than I am about the rise of China as a threatening power, but in any case I will end, not by my own views, but by Lee Kuan Yew's view. He was always a very shrewd observer of US and China relations and I once asked him whether he thought that China would pass the US and he said, 'They're going to give you a good run for your money, but I don't think they going to pass you.' I said, 'Why?' He said, 'China can call upon the talents of 1.3 billion

people, but the United States can call upon the talents of seven billion people and what's more it can recombine them in a diversity, which leads to much more creativity than you can get under ethnic Han nationalism.' This by an ethnic Han. I think he's probably right. I hope he is, but it's up to you now to question me and if, as to whether we are right. Thank you.