

CHINA AND THE U.S. REBALANCE TO ASIA

HEARING
BEFORE THE
U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

ONE HUNDRED FOURTEENTH CONGRESS
SECOND SESSION

THURSDAY, MARCH 31, 2016

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UNITED STATES-CHINA ECONOMIC AND SECURITY REVIEW
COMMISSION

WASHINGTON: 2016

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The Commission was created on October 30, 2000 by the Floyd D. Spence National Defense Authorization Act for 2001 § 1238, Public Law No. 106-398, 114 STAT. 1654A-334 (2000) (codified at 22 U.S.C. § 7002 (2001), as amended by the Treasury and General Government Appropriations Act for 2002 § 645 (regarding employment status of staff) & § 648 (regarding changing annual report due date from March to June), Public Law No. 107-67, 115 STAT. 514 (Nov. 12, 2001); as amended by Division P of the “Consolidated Appropriations Resolution, 2003,” Pub L. No. 108-7 (Feb. 20, 2003) (regarding Commission name change, terms of Commissioners, and responsibilities of the Commission); as amended by Public Law No. 109-108 (H.R. 2862) (Nov. 22, 2005) (regarding responsibilities of Commission and applicability of FACA); as amended by Division J of the “Consolidated Appropriations Act, 2008,” Public Law No. 110-161 (December 26, 2007) (regarding responsibilities of the Commission, and changing the Annual Report due date from June to December); as amended by the Carl Levin and Howard P. “Buck” McKeon National Defense Authorization Act for Fiscal Year 2015, P.L. 113-291 (December 19, 2014) (regarding responsibilities of the Commission).

The Commission’s full charter is available at www.uscc.gov.

May 12, 2016

The Honorable Orrin Hatch
President Pro Tempore of the Senate, Washington, D.C. 20510
The Honorable Paul Ryan
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR HATCH AND SPEAKER RYAN:


We are pleased to notify you of the Commission's March 31, 2016 public hearing on "China and the U.S. Rebalance to Asia." The Floyd D. Spence National Defense Authorization Act (amended by Pub. L. No. 113-291) provides the basis for this hearing.

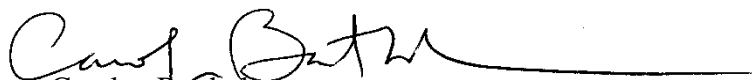
At the hearing, the Commissioners received testimony from the following witnesses: Mr. Dan Blumenthal, Director of Asian Studies, American Enterprise Institute; Dr. Kathleen H. Hicks, Senior Vice President, Chair, and Director, International Security Program, Center for Strategic and International Studies; Dr. Mira Rapp-Hooper, Senior Fellow, Asia-Pacific Security Program, Center for a New American Security; Dr. Matthew Goodman, Political Economy Chair and Senior Adviser for Asian Economics, Center for Strategic and International Studies; Dr. Elizabeth Economy, Senior Fellow and Director for Asia Studies, Council on Foreign Relations; Dr. Dean Baker, Co-Director, Center for Economic and Policy Research; Dr. David Lampton, Professor and Director of SAIS-China and China Studies, Johns Hopkins School of Advanced International Studies; Mr. Walter Lohman, Director, Asian Studies Center, The Heritage Foundation; and Dr. Sheila Smith, Senior Fellow for Japan Studies, Council on Foreign Relations. This hearing examined the origins, implementation, and impacts of the U.S. "Rebalance to Asia" strategy, now in its fourth year. It assessed the reactions of China and other regional countries to the Rebalance, and evaluated areas of strength and weakness. The hearing also explored what objectives and policies will best serve U.S. regional interests moving into a new Administration.

We note that prepared statements for the hearing, the hearing transcript, and supporting documents submitted by the witnesses are available on the Commission's website at www.USCC.gov. Members and the staff of the Commission are available to provide more detailed briefings. We hope these materials will be helpful to the Congress as it continues its assessment of U.S. - China relations and their impact on U.S. security.

The Commission will examine in greater depth these issues, and the other issues enumerated in its statutory mandate, in its 2016 Annual Report that will be submitted to Congress in November 2016. Should you have any questions regarding this hearing or any other issue related to China, please do not hesitate to have your staff contact our Congressional Liaison, Anthony DeMarino, at (202) 624-1496 or via email at ADeMarino@uscc.gov.

Sincerely yours,


Hon. Dennis C. Shea
Chairman


Carolyn Bartholomew
Vice Chairman

CONTENTS

THURSDAY, MARCH 31, 2016

CHINA AND THE U.S. REBALANCE TO ASIA

| | |
|--|----|
| Opening Statement of Vice Chairman Carolyn Bartholomew (Hearing Co-Chair) | 01 |
| Prepared Statement..... | 03 |
| Opening Statement of Commissioner James Talent (Hearing Co-Chair) | 05 |
| Prepared Statement..... | 06 |

Panel I: Objectives and Future Direction for Rebalance Security Policies

| | |
|--|----|
| Panel I Introduction by Vice Chairman Carolyn Bartholomew (Hearing Co-Chair) | 07 |
| Statement of Mr. Dan Blumenthal Director of Asian Studies, American Enterprise Institute..... | 08 |
| Prepared Statement..... | 10 |
| Statement of Dr. Kathleen H. Hicks Senior Vice President, Chair, and Director, International Security Program, Center for Strategic and International Studies..... | 19 |
| Prepared Statement..... | 21 |
| Statement of Dr. Mira Rapp-Hooper Senior Fellow, Asia-Pacific Security Program, Center for a New American Security . | 25 |
| Prepared Statement..... | 28 |
| Panel I: Question and Answer..... | 35 |

Panel II: Objectives and Future Direction for Rebalance Economic Policies

| | |
|--|----|
| Panel II Introduction by Commissioner James Talent (Hearing Co-Chair) | 53 |
| Statement of Dr. Matthew Goodman, Political Economy Chair and Senior Adviser for Asian Economics, Center for Strategic and International Studies | 54 |
| Prepared Statement..... | 56 |
| Statement of Dr. Elizabeth Economy Senior Fellow and Director for Asia Studies, Council on Foreign Relations | 62 |
| Prepared Statement..... | 65 |
| Statement of Dr. Dean Baker Co-Director, Center for Economic and Policy Research | 71 |
| Prepared Statement..... | 74 |

| | |
|-------------------------------------|----|
| Panel II: Question and Answer | 80 |
|-------------------------------------|----|

Panel III: Chinese and Regional Responses to the Rebalance

| | |
|---|-----|
| Panel III Introduction by Vice Chairman Carolyn Bartholomew (Hearing Co-Chair) | 96 |
| Statement of Dr. David Lampton Professor and Director of SAIS-China and China Studies, Johns Hopkins School of Advanced International Studies | 97 |
| Prepared Statement..... | 99 |
| Statement of Mr. Walter Lohman Director, Asian Studies Center, The Heritage Foundation | 107 |
| Prepared Statement..... | 109 |
| Statement of Dr. Sheila Smith Senior Fellow for Japan Studies, Council on Foreign Relations | 118 |
| Prepared Statement..... | 121 |
| Panel III: Question and Answer | 126 |

CHINA AND THE U.S. REBALANCE TO ASIA

THURSDAY, MARCH 31, 2016

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

Washington, D.C.

The Commission met in Room G-50 of Dirksen Senate Office Building, Washington, DC 9:00 a.m. Vice Chairman Carolyn Bartholomew and Senator James Talent (Hearing Co-Chairs), presiding.

OPENING STATEMENT OF VICE CHAIRMAN CAROLYN BARTHOLOMEW HEARING CO-CHAIR

VICE CHAIRMAN BARTHOLOMEW: Welcome. Welcome, everyone. We'll go ahead and begin. Welcome to the fourth hearing of the U.S.-China Economic and Security Review Commission's 2016 Annual Report cycle. Thank you all for your attendance today.

Today's hearing will assess the origins, implementation, and future direction of the U.S. "Rebalance to Asia" strategy, launched by the administration more than four years ago. We will be taking a close look at both the economic and security aspects of the rebalance as well as how countries in the region have responded.

Over the course of the rebalance, U.S. ties to the Asia Pacific have grown and our relations with longstanding allies have deepened. We have worked to increase our military cooperation with Australia and the Philippines. Japan is taking on a more active role in promoting regional security, and the United States has concluded new host nation support agreements with both Japan and South Korea.

We have also reached out to new partners, for example, opening a new chapter in U.S. relations with Burma and with Vietnam and boosting our cooperation with India's armed forces.

Paired with these deepening ties, the U.S. has also worked to increase its economic engagement in Asia. Today, East and Southeast Asia account for 34 percent of U.S. trade in goods. China is 13 percent of U.S. trade in goods and services. The other countries in the region account for 18 percent in goods. While there are no good numbers about trade in services to the other countries, it is clear that there are many opportunities for growth in a number of U.S. business sectors.

The Obama administration has advanced its economic vision for the region, most publicly through the TPP. While the administration has argued that it is a central component of the rebalance to Asia, many question its impact here in the U.S., and its future is not guaranteed.

Meanwhile, China has not been idle. China strongly backs the Regional Comprehensive Economic Partnership, a parallel regional trade agreement, and has committed to high levels of regional infrastructure spending through its One Belt One Road projects. The administration, our administration, should thus develop more ways to foster regional economic growth and promote U.S. economic leadership.

I look forward to our witnesses' discussion today on what can be done on this front and how the Chinese initiatives would affect the U.S. rebalance.

Our examination occurs at an important time for U.S. strategy. As we transition from one administration to the next the beginning of next year, our country's next leader must have a firm understanding of what the rebalance was meant to accomplish and how it has been implemented.

The next administration must also be equipped with thoughtful recommendations on how the rebalance can be improved and adjusted to new circumstances. To assist in this regard, we are joined by distinguished experts and long-time observers of U.S. Asian strategy. We appreciate and look forward to all of their testimony.

Before I turn the floor over to my co-chair for this hearing, Senator Jim Talent, I thank Senate Minority Leader Harry Reid and his staff for providing us with this room today, and as always I would like to express my appreciation to the Commission staff who worked hard to put this hearing together: Jordan Wilson, Matt Snyder, Nargiza Salidjanova, and Caitlin Campbell.

With that, I'll turn it over to Jim Talent.

**PREPARED STATEMENT OF VICE CHAIRMAN CAROLYN BARTHOLOMEW
HEARING CO-CHAIR**

Hearing on “China and the U.S. Rebalance to Asia”

**Opening Statement of Vice Chairman Carolyn Bartholomew
March 31, 2016
Washington, DC**

Good Morning. Welcome to the fourth hearing of the U.S.-China Economic and Security Review Commission’s 2016 Annual Report cycle and thank you for your attendance today.

Today’s hearing will assess the origins, implementation, and future direction of the U.S. “Rebalance to Asia” strategy, launched by the Administration more than four years ago. We will be taking a close look at both the economic and security aspects of the Rebalance, as well as how countries in the region have responded.

Over the course of the Rebalance, U.S. ties to the Asia Pacific have grown and our relations with long-standing allies have deepened. We have worked to increase our military cooperation with Australia and the Philippines. Japan is taking on a more active role in promoting regional security, and the United States has concluded new host nation support agreements with both Japan and South Korea. We have also reached out to new partners, for example, opening a new chapter in U.S. relations with Burma and Vietnam and boosting our cooperation with India’s armed forces.

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**OPENING STATEMENT OF COMMISSIONER JAMES TALENT
HEARING CO-CHAIR**

HEARING CO-CHAIR TALENT: Thank you, Vice Chairman Bartholomew. I also want to welcome our panelists and guests to this hearing.

Overall, the Rebalance to Asia strategy enjoys broad bipartisan consensus support among U.S. policy experts and within both the administration and Congress. In other words, there's substantial agreement that it is, broadly speaking, the right policy. However, there is also substantial concern that given the decline in America's military capabilities because of defense sequestration, whether the policy is adequately supported by strong enough presence and power in the region.

Certainly, the policy has not yet been effective in curbing Chinese coercion in the East and South China Seas. China has worked relentlessly to assert sovereignty unilaterally and to tilt the regional military balance in its favor. It is thus crucial to consider, within the context of overall U.S.-Asia Pacific strategy, how the United States can best respond to China's actions and bolster regional stability. As American officials have noted, getting China right requires getting the region right.

We're also cognizant of other important concerns within the regional scope of the Rebalance Strategy, most notably the continued challenge of North Korean denuclearization. Others include: territorial disputes in the East China Sea; Russia's heightened interest in the Asia Pacific; opportunities to encourage human rights protections in Burma, Vietnam and elsewhere; and numerous important bilateral and multilateral U.S. relationships.

The Asia Pacific will remain an area of great growth and opportunity going forward and continued U.S. engagement and leadership will be essential. Finding ways to fully resource the Rebalance Strategy and ensure it reflects U.S. interests and objectives will thus be of great importance.

Today, we look forward to exploring these challenges and opportunities in more detail and hearing the insights and recommendations of our excellent lineup of panelists who are with us today.

As a reminder, the testimonies and transcript from today's hearings will be posted on our website. You'll find a number of other resources there, including our Annual Reports, staff papers, and links to important news stories about China and U.S.-China relations. Also, please mark your calendars for the Commission's next hearing on China's 13th Five-Year Plan, which will take place on April 27.

**PREPARED STATEMENT OF COMMISSIONER JAMES TALENT
HEARING CO-CHAIR**

Hearing on “China and the U.S. Rebalance to Asia”

**Opening Statement of Senator James Talent
March 31, 2016
Washington, DC**

Thank you, Vice Chairman Bartholomew, and I also welcome our panelists and guests to this hearing.

Overall, the Rebalance to Asia strategy enjoys a broad, bipartisan consensus among U.S. policy experts, and within both the Administration and Congress. In other words, there is substantial agreement that it is, broadly speaking, the right *policy*. However, there is also concern that the policy is not defined well enough or consistently enough, and even greater concern – given the decline in America’s military capabilities because of defense sequestration – whether the policy is adequately supported by strong enough *presence and power* in the region.

Certainly the policy has not yet been effective in curbing Chinese coercion in the East and South China Seas. China has worked relentlessly to assert its sovereignty unilaterally and to tilt the regional military balance in its favor. It is thus crucial to consider, within the context of overall U.S.-Asia Pacific strategy, how the United States can best respond to China’s actions and bolster regional stability. As U.S. officials have noted, getting China right requires getting the region right.

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PANEL I INTRODUCTION BY VICE CHAIRMAN CAROLYN BARTHOLOMEW

VICE CHAIRMAN BARTHOLOMEW: Thank you.

So we'll move forward with introducing our first panel, titled "Objectives and Future Direction for Rebalance Security Policies." This panel will explore U.S. security interests and objectives in the Asia Pacific region, evaluate the extent to which the Rebalance Strategy has achieved the objectives, and consider recommendations for the security component of the strategy going forward.

First, we'll hear from Dan Blumenthal. Mr. Blumenthal is the Director of Asian Studies at the American Enterprise Institute where he focuses on East Asian security issues and Sino-American relations.

He has both served in and advised the U.S. government on China issues for over a decade--I think it was probably over two decades now, Dan, isn't it--both as Senior Director for China, Taiwan, and Mongolia at the Department of Defense from 2001 to 2004 and as a Commissioner here with us at the U.S.-China Economic and Security Review Commission from 2006 to 2012.

Next, we'll have Dr. Kathleen Hicks speak. Dr. Hicks is the Senior Vice President, and the Henry A. Kissinger Chair, and the Director of the International Security Program at the Center for Strategic and International Studies, CSIS.

Dr. Hicks served as a senior civilian official in the U.S. Department of Defense from 2009 to 2013 and is a frequent writer and lecturer on U.S. foreign and security policy issues. She recently served as a lead co-author of CSIS' congressionally-mandated report "Asia Rebalance 2035," published in January of this year.

And then we'll have Dr. Mira Rapp-Hooper. Dr. Rapp-Hooper is a Senior Fellow with the Asia-Pacific Security Program at the Center for New American Security. She previously directed the Asia Maritime Transparency Initiative at CSIS and was also formerly a Stanton Nuclear Security Fellow at the Council on Foreign Relations. She has written extensively on Asia security issues, and her work has appeared in numerous leading journals and media outlets.

For all of our panelists, please keep your remarks to seven minutes. I'd note for our audience that I greatly shortened the distinguished resumes of all of our witnesses. If people want to know more, we can provide more information about their terrific backgrounds, and I want to thank everybody in particular for joining us today on a day when getting around this city is probably about as difficult as I've seen it in a long time. So thank you very much.

Mr. Blumenthal, we'll start with you.

**OPENING STATEMENT OF MR. DAN BLUMENTHAL
DIRECTOR OF ASIAN STUDIES, AMERICAN ENTERPRISE INSTITUTE**

MR. BLUMENTHAL: Thank you, and it's about a decade-and-a-half actually. But it's great to be here and it's great to be back with the U.S-China Economic and Security Commission, back on this side of the dias where I first started. And it's great to be on this panel with terrific experts and colleagues, Dr. Hicks and Dr. Rapp-Hooper, who have contributed so much to our understanding of our strategy or what our strategy should be going forward in the Asia Pacific.

In my short time--you have my written testimony--but in my short time I hope to leave you with three takeaways, the first one is I believe that we need to see our interests in Asia-Pacific as tied to a post-World War II grand strategy of maintaining a preponderance of power across Eurasia--Europe, the Middle East, and the Asia-Pacific. So I don't believe we can really see U.S. objectives in Asia without looking at the entirety of that strategy--or we can achieve our objectives, at least.

The second takeaway I'd like to leave you with is that I think our security policies and our military strategy needs to operate with a greater diplomatic political framework. As you're asking today, we must continually ask ourselves, what are we doing? What are we trying to achieve with our military exercises and so forth and our alliances? And I definitely believe, and I will flesh it out further in my short time, that we need a more diplomatically active initiative, particularly in the South China Sea, where we take more of a leadership role in trying to resolve disputes among our friends and allies, at least.

And then over the long-term, while we're doing quite a bit to improve our posture within our current alliance framework, I think we, our diplomats and our policymakers, need to really think and plan as much as possible for a permanent presence southwest of Okinawa where I think we're really hurting without having more of a permanent presence, and I know that's difficult work, but I think it's an aspiration we should try to work towards.

Let me quickly go through some of the questions that you ask, and I laid it out in more detail in the written testimony, but our interests I think have been the same for a long time from World War II or before then, and that's always been to a certain extent defending our homeland far forward; it's been preserving a favorable balance for ourselves and our allies in East Asia and that part of Eurasia; ensuring free access to the military and maritime commons, and therefore gaining as much political influence as possible; preserving the U.S. way of life by continuing to shape an international liberal order; and building a network of friends and allies who are able to support our interests and our principles.

As to your questions, are any of these interests threatened, I think, as you know, the answer is, yes, they are. I think that the way I would put it, in terms of Chinese military, and we're talking about China right now obviously--in question and answer, we can talk about North Korea, but I'm focusing on the South China Sea in particular--but China has developed a set of capabilities that you know quite well.

People call them different things--aerial denial and anti-access. The Russians used to call this suite of capabilities the "precision strike complex," something that our military had a monopoly over for so long. China has developed the precision strike complex, which is essentially the ability to deliver, through air, sea, sub-sea, space, cyber, precision, precision-guided munitions that can now target our bases deployed forward, as well as our logistical lines that we need to surge forces forward in an emergency.

Those two things have been the basis of our military strategy in the Asia-Pacific, the ability both to be forward deployed and to surge forces from anywhere in the world to command the commons when we need to, and both of those are very much at risk right now.

In terms of what the security objectives of the rebalance are, you know, first I would say that there are two premises that I see within the Rebalance Strategy, one is that the assumed "Asian century" is upon us, and our history will be written increasingly in East Asia, and I think that that has been something that we've decided on or thought as a nation since the end of the Cold War, at least if not before.

And the second premise that I see is that the Middle East was somewhat of a distraction from higher order U.S. strategic goals in Asia.

I think the first premise is correct or probably correct although with long-term economic stagnation, maybe it will be less correct in the next ten years or so, but that is probably a topic for another hearing.

The second premise is a little bit faulty because, as we've learned over the last few years, if we look like we're balancing forces away from any region, it creates problems, particularly the Middle East, but--and they're not saying that was the intent of the Rebalance Strategy, but perhaps that was part of the effect, and Middle East and Asia are so interconnected in terms of energy and oil, in terms of just the growing jihadi threat, which is affecting Muslim-majority countries throughout East Asia, in terms of the way our partners, like India, are able to operate or not operate in East Asia if they're distracted themselves by jihadi threat.

So I think--and, of course, the role of Russia, in a sense, that whatever we do with Russia in Europe, we got to keep our eye on the ball because we could be pushing them into more of an alliance with China. So I think we need to think geopolitically when it comes to the rebalance.

I only have a little time left so I'm going to close with what I think we should do in terms of a diplomatic initiative that will, I think, really give some purpose to our military exercises. I think that ASEAN is not going to, on its own, resolve the disputes in the South China Sea. I think the United States should undertake a new diplomatic initiative that works with our claimant friends and those who have interest in the South China Sea to first try to resolve disputes amongst themselves.

I think we can do this on a bilateral, trilateral basis. I think we should be shuttling through the capitals of some of these claimant nations. I think once we do that, of course, it's very hard work, and many people will say it's not possible, but I think we do that, we would be able to actually clarify the purposes behind many of our military activities from FONOPS to defending our territories in, or defending or helping our allies defend their now defined territories in the South China Sea.

I think the alternative is what we see right now, which is our friends and allies actually losing territory and rights with the status quo. The status quo is not sustainable.

Let me stop there because I think I'm over my time, but I'm happy to take questions afterwards.

**PREPARED STATEMENT OF MR. DAN BLUMENTHAL
DIRECTOR OF ASIAN STUDIES, AMERICAN ENTERPRISE INSTITUTE**

**Testimony before the US-China Economic and Security Review
Commission: Objectives and Future Direction for Rebalance
Security Policies**

*Dan Blumenthal
Director of Asian Studies, AEI
March 31, 2016*

Thank you to the US-China Economic and Security Review Commissioners for inviting me to testify today. It is a privilege to be back with you—this time from the other side of the dais.

I hope to leave you with three main takeaways. (1) US interests in the Asia-Pacific have been tied to a post-World War II grand strategy of maintaining a preponderance of power across Eurasia (in Europe, the Middle East, and the Asia-Pacific). US objectives in Asia cannot be viewed in isolation from that strategic conception. (2) US security policies must operate within a diplomatic-political framework. We must continually ask, as you are right now, “What are we trying to achieve with our military and alliances?” In my view, Washington must become more diplomatically active in resolving territorial disputes plaguing the region, particularly in Southeast Asia. (3) Over the long term, the US needs as permanent a basing presence as possible southwest of Okinawa.

Let me flesh out these thoughts by responding to your specific questions:

What interests does the United States have in the Asia-Pacific, and how do these relate to the world order the United States seeks to promote?

Since the end of World War II, the United States has pursued a strategy of primacy across Eurasia.¹ Regarding Asia specifically, successive US presidents have found that this strategy has best served our interests, which in Asia include:

- 1) Defending the US homeland far forward;
- 2) Preserving a favorable balance of power in Eurasia, so that no power can dominate the continent;
- 3) Ensuring free military and commercial access to Asia’s maritime commons, while maintaining a high degree of political influence on continental Asia;
- 4) Preserving and continuing to refine the liberal international order consistent with the “US way of life,” as the framers of the US Cold War strategy put it; and
- 5) Building a network of friends and allies who support our interests.

US grand strategy has been largely successful. It has tamed security competitions between

¹ This includes the Carter Doctrine addendum, which added the Persian Gulf as an area of prime US security interests.

historic Asian rivals and created the conditions for dizzying economic growth—allowing us to even consider that we may face an “Asian century.”

Are any of these interests threatened currently, and, if so, how should the United States respond?

The short answer is yes. As the commission knows well, since the end of the Cold War, China has developed its economic and military capacity to challenge our interests in Asia. In recent years, Beijing has utilized its instruments of national power for coercive purposes, even though China has been one of the greatest beneficiaries of the system the US shaped—one of open economies, free maritime commons, and sets of rules and customs meant to stem proliferation and generally tame rivalries.

It should be no surprise that China is translating wealth into power to further its ambitions for a national rejuvenation. The People’s Republic is acting like every rising power before it. The only surprise is that many people are surprised.

Beijing’s actions are inherently destabilizing. While China’s economic growth thus far has occurred within the framework of the liberal economic system, it is now developing alternative economic institutions meant to further its political purposes, which include the dilution of US interests and the recreation of a “Sinosphere”—the natural state of geopolitics in Chinese eyes.²²

In the security realm, the purview of this panel, China poses a serious challenge to the military strategy that has undergirded America’s grand strategy of primacy. What are the elements of US defense strategy in Asia?

- 1) A forward basing posture for combat aircraft, large numbers of SSN and SSBN submarines, and carrier strike-groups to project power in Asia. US “boomer” submarines, armed with ICBMs, lurk underwater ready to act. These assets provide a continual, silent deterrent, while carrier strike groups present highly visible symbols of US power.
- 2) Control of the commons and the ability to summon overwhelming force anywhere and anytime. For the US to continue to be the prime player in Asia, it must retain the ability to command Asia’s commons. This requires that the US properly steward its alliances and partnerships in order to maintain a forward deployed posture, while also adequately funding our military to ensure that our air and naval assets are modernized and ready for quick deployment.

It will be no surprise to you that China’s military strategy thus far has been to “defeat the enemy’s strategy.” The People’s Liberation Army (PLA) has built a precision strike complex made up of a ballistic and cruise missile force, undersea capabilities, integrated air defense, counter-space and cyber capabilities, and bombers and fighters that can deliver additional

² Institutions such as the Asian Infrastructure Investment Bank.

firepower against US and allied assets within Asia's "First Island Chain." For a time that in retrospect appears brief, this type of precision strike complex was the monopoly of the US military.

The PLA has created contested zones in its "near seas," allowing it to deny the US access to parts of the commons in the Western Pacific. The PLA can now threaten US logistical supply lines and bases throughout Asia, while also holding US assets at risk in space and cyberspace.

This military strategy is meant to exact a serious cost on US military forces attempting to project power into the "First Island Chain" and interdict US forces surging into Asia during a crisis. For example, in the event of conflict, carrier strike groups, the iconic symbol of US power projection, could face swarms of Chinese hypersonic cruise missiles, anti-ship ballistic missiles (or what are called in the press "carrier-killers"), and packs of diesel electric submarines. The PLA air force's increasingly modern fleet of aircraft provides China with additional range in striking US bases and carrier groups.

Under the cover of these contested zones, China can employ coercive power against its neighbors to further its maritime and geopolitical interests. This strategy is undermining the foundations of US primacy. Absent primacy, it will be very difficult for the US to protect the other interests stated above.

We may not know with exactitude the nature of Chinese long-term plans for the region, but we do know that a China with greater coercive power will have a more substantial say in the economic and political life of this crucial region.

What are the security objectives of the Rebalance, and how have these evolved over time? Do these objectives reflect US regional and global interests, and are they permitting effective planning and execution of the security component of the Rebalance?

In 2011 President Obama announced a strategic "Pivot" or "Rebalance" to Asia. The strategy has two main premises.

- 1) Given the assumed rise of an "Asian Century," more diplomatic and military power must be deployed to the Asia-Pacific region.
- 2) US involvement in the Middle East was a "distraction" from higher-order US strategic goals in Asia.

The first premise may be correct—although the seemingly long-term economic stagnation of China may call into question the viability of an "Asian Century."³

The second strategic premise has proved faulty. As we have learned, if the US is to remain the world's international leader, the sole superpower, we cannot pivot from any of Eurasia's critical regions. Russia still has designs on Europe. When we retrench from the Middle East, problems arguably grow worse.

³ Perhaps a topic for a separate hearing.

These regions are interconnected. Large Asian nations are importers of oil from the Middle East, and US partners in Asia look to Washington to keep open the sea-lines of communication (SLOCs) from the Pacific through the Indian Ocean. New partners are crucial to maintaining a favorable balance of power in Asia, but India, for example, will not play the role the US wishes it to in East Asia if jihadi terror festers on its western flank. Some of America's largest would-be friends in Asia, such as Indonesia, have majority Muslim populations and are concerned about the return of global jihadi threats. Australia, one of Washington's closest allies in Asia, regards radicalization in Indonesia as a prime security concern.

Russia also remains a player in East Asia—maybe a growing one if its energy exports are banned from Europe for the long term. The US must be mindful that it does not make it convenient for China and Russia to band together. In short, the US must think geopolitically and not just regionally.

Even so, regional strategies that enhance our geopolitical goals are necessary. So let us assess the success of the Rebalance on its own terms. The Pentagon's 2012 Defense Strategic Guidance document states the following as US strategic goals in Asia:⁴

- Promoting a rules-based international order that ensures underlying stability and encourages the peaceful rise of new powers, economic dynamism, and constructive defense cooperation;
- Expanding networks of cooperation with emerging partners throughout the Asia-Pacific to ensure collective capability and capacity for securing common interests; and
- Ensuring that US forces maintain regional access and the ability to operate freely in order to promote stability and the free flow of commerce.

According to the *Asia-Pacific Maritime Security Strategy*, released by the Pentagon in 2015, US security goals include:⁵

- Strengthen US military capacity in the Asia-Pacific to deter conflict and coercion;
- Build maritime capacity for allies and partners;
- Strengthen maritime rules of the road; and
- Build regional security institutions to encourage the development of an open regional security architecture.

Strengthening US military capacity, offering allies and partners security assistance, and defending the maritime rules of the road are fine goals, but to plan and execute more effectively, the next administration will need to be clear about which security institutions should be strengthened or created and which states should be part of an “open regional security architecture.”

⁴ US Department of Defense, *Sustaining U.S. Global Leadership: Priorities for 21st Century Defense*, January 2012, http://archive.defense.gov/news/Defense_Strategic_Guidance.pdf.

⁵ US Department of Defense, *Asia-Pacific Maritime Security Strategy*, http://www.defense.gov/Portals/1/Documents/pubs/NDAA%20A-P_Maritime_Security_Strategy-08142015-1300-FINALFORMAT.PDF.

I believe we need to operate at two levels. First, we need to find ways to better build coalitions of allies and friendly nations that operate together and further common interests. While an Asian NATO is not in the cards, a coalition of allies could work more closely together. For example, I believe that the US should be more active in its diplomacy in the South China Sea (SCS), assisting our allies and partners, who are claimants affected by China's expansive 9-dash line claim, to resolve disputes among themselves.⁶

Within an allied and partner diplomatic framework, Washington could more effectively posture our military and build partner capacity to help our friends protect their territories and rights, shaping the South China Sea in ways consistent with our interests in maintaining free and open maritime commons.

Second, we need regional security organizations, of which China is a part, to tame rivalries and find diplomatic solutions where our interests diverge.

Assess the implementation of the security component of the Rebalance. Have sufficient resources been devoted to achieving stated US objectives for this component, and what policy and investment changes, if any, should be made going forward? Is the United States investing sufficient resources to meet the requirements of the emerging Joint Concept for Access and Maneuver in the Global Commons (JAM-GC)?

Let me answer both questions together. In response to China's anti-access area denial (A2/AD) strategy, the US military must strive to maintain the ability to forward deploy and command the commons. This includes continuing to disperse, harden, and find new permanent basing in Asia; add forward deployed capacity; and modernize its air and naval arsenal. I will break down my assessment of the Rebalance security implementation into several parts: posture, partner cooperation, capacity, and capability.

Posture. The US Air Force currently relies heavily on Kadena Air Base in Okinawa, Kunsan and Osan Air Bases in South Korea, and Anderson Air Base in Guam; however these airfields are increasingly vulnerable to attack from China's suite of advanced ballistic and cruise missiles. The Rebalance has included several positive steps with regard to US posture in the region.

- 1) In 2011–2012, the US announced the rotational deployment of four Littoral Combat Ships in Singapore and of 2,500 marines to Darwin, Australia.
- 2) In January 2016, the Philippine Supreme Court ruled in favor of the Enhanced Defense Cooperation Agreement (EDCA), which will open up air and naval bases in the Philippines to US troops on a rotational basis. Just last week, it was reported that the US has received access to four new air bases in the Philippines.⁷

⁶ Daniel Blumenthal and Michael Mazza, "A New Diplomacy to Stem Chinese Expansion," *Wall Street Journal*, June 10, 2015, <http://www.wsj.com/articles/a-new-diplomacy-to-stem-chinese-expansion-1433952079>.

⁷ These four bases are Basa Air Base in Luzon, Antonio Bautista Air Base in Palawan, Mactan-Benito Ebuen Air Base in Cebu, and Lumbia Air Base. Armando J. Heredia, "Analysis: New U.S.-Philippine Basing Deal Heavy on Air Power, Light on Naval Support," USNI News, March 22, 2016, <http://news.usni.org/2016/03/22/analysis-new-u-s-philippine-basing-deal-heavy-on-air-power-light-on-naval-support>.

Even with these additions, rotational access will not make up for the fact that the US has no permanent presence southwest of Okinawa, even as the center of gravity of the Sino-American rivalry moves to the South China Sea. A longer-term goal for our diplomats should be for the US to build a permanent presence in Southeast Asia.

Partner Cooperation. As part of the pivot, the US has taken a number of smaller steps to enhance cooperation with allies and partners.

- 1) In Northeast Asia, the US has revised and updated its treaty with Japan to include enhanced joint operations, sold state of the art drones and Ospreys to Tokyo, and is currently in THAAD negotiations with Seoul.
- 2) In Southeast Asia, the administration partially lifted the long-standing US arms embargo with Vietnam.⁸ It has also pushed the Southeast Asia Maritime Security Initiative that will (hopefully, pending congressional funding) provide more than \$425 million in maritime capacity building over the next five years to Indonesia, Malaysia, the Philippines, and Vietnam. The US still spends only 1 percent of its Foreign Military Financing (FMF) in Asia—a figure that is not commensurate with our interests in the region. The Foreign Military Sales (FMS) program is another highly effective way to both build partner capacity and alliance cohesion. The US effectively used these programs to help South Korea, Japan, and Taiwan develop modern militaries.

Capacity. The government has not properly funded the rebalance.

- 1) According to the Congressional Budget Office (CBO), the Obama administration's FY2010 defense budget request of \$534 billion was \$40 billion below the level necessary to fund its own defense plans.⁹
- 2) Then in 2011, the Budget Control Act (BCA) made the defense budget problem even worse. The BCA eliminated \$400 billion in defense spending between 2012 and 2021 from the FY2012 budget request. If BCA is not reversed, it could strip more than \$1 trillion from the Department of Defense over time.¹⁰
- 3) In 2014, the National Defense Panel recommended a return to the Gates FY2012 budget baseline (FY2017 \$649 billion). By comparison, the administration's FY2017 base budget request is \$551 billion.¹¹
- 4) The US Navy's battle fleet is currently down to 272 ships. The National Defense Panel recommended a 323-345 ship fleet, but if sequestration remains in place, the Navy could fall to as low as 260 ships.¹²

⁸ Michael R. Gordan, "U.S. Eases Embargo on Arms to Vietnam," *New York Times*, October 2, 2014, <http://www.nytimes.com/2014/10/03/world/asia/us-eases-embargo-on-arms-to-vietnam.html>.

⁹ Marilyn Ware Center for Security Studies, *To Rebuild America's Military*, American Enterprise Institute, October 2015, 64, <http://www.aei.org/wp-content/uploads/2015/10/To-Rebuild-Americas-Military.pdf>.

¹⁰ *Ibid.*, 65.

¹¹ Mackenzie Eaglen and Rick Berger, "2017 Defense Budget: Offset Promising, but Today's Procurement Disproportionately Pays the Bills," American Enterprise Institute, February 2016, <http://www.aei.org/publication/2017-defense-budget-offset-promising-but-procurement-pays-bills/>.

¹² Mackenzie Eaglen and David Adesnik, *State of the US Military: A Defense Primer*, American Enterprise Institute and the

- 5) In addition, the Navy has only 44 of the 77 ships its needs equipped with ballistic missile defense.¹³ For 10 years (from 2025 to 2035), the Navy will fall below its 48-boat SSN requirement.¹⁴ For 15 years (from 2027 to 2041), the Navy will fall below its 14-boat SSBN deterrence requirement.¹⁵
- 6) Budget shortcomings have also resulted in gaps in US presence in the Asia-Pacific. For example, in FY2013 the US had no carrier on patrol in the Western Pacific for five months. (USS George Washington was in port, but no other carrier was present in the PACOM area of responsibility.)¹⁶
- 7) In recent testimony before the Senate Armed Services Committee, PACOM Commander Admiral Harry Harris stated that he lacks sufficient submarine capacity to carry out the required mission set in his area of responsibility (AOR).¹⁷

Capabilities. There have been good suggestions on how to enhance our capabilities in the face of the Chinese precision strike regime from think tanks such as CSIS, CSBA, and AEI. All agree that the US needs additional survivable stealthy attack aircraft, airlift capabilities, THAAD and other ballistic missile defense, an accelerated long range bomber program, UAVs, innovative subsurface capabilities (UUVs), and especially more submarines.¹⁸

What opportunities does the United States have to further security cooperation with regional allies and partners, as part of the security component of the Rebalance? Are current efforts under the Rebalance strategy sufficient? What obstacles exist, and what conditions would be required to implement other forms of security cooperation? What countries outside the Asia-Pacific have interests in the region that align with those of the United States, and are current conditions conducive to stronger policy coordination?

Opportunities

Beijing's aggressiveness in the South and East China Seas has created more potential friends and allies for us than our diplomacy alone could have accomplished.

In addition to the new access arrangements and closer military ties Washington has negotiated with the Philippines and Australia, the US has enhanced its maritime training regiments with Indonesia and Vietnam. The US should focus on initiatives that knit together our allies and partners. I have written on this topic with colleagues, as has Dr. Rapp-Hooper—coalition

Foreign Policy Initiative, October 2015, 5, <http://www.aei.org/wp-content/uploads/2015/10/State-of-the-US-Military.pdf>.

¹³ Ibid, 12.

¹⁴ Deputy Chief of Naval Operations, *Report to Congress on Annual Long-Range Plan for Construction of Naval Vessels for FY2015*, Office of the Chief of Naval Operations, June 2014, <http://navylive.dodlive.mil/files/2014/07/30-year-shipbuilding-plan1.pdf>.

¹⁵ Ibid.

¹⁶ Mackenzie Eaglen and David Adesnik, *State of the US Military: A Defense Primer*, American Enterprise Institute and the Foreign Policy Initiative, October 2015, 18, <http://www.aei.org/wp-content/uploads/2015/10/State-of-the-US-Military.pdf>.

¹⁷ To address this, the Pentagon might consider adding two Los Angeles class attack submarines to Guam or homeporting Virginia class SSNs in Indian Ocean, potentially in Diego Garcia.

¹⁸ See for example Marilyn Ware Center for Security Studies, *To Rebuild America's Military*, American Enterprise Institute, October 2015, <http://www.aei.org/wp-content/uploads/2015/10/To-Rebuild-Americas-Military.pdf>; Andrew F. Krepinevich, "Maritime Competition in a Mature Precision-Strike Regime," Center for Strategic and Budgetary Assessments, April 13, 2015, <http://csbaonline.org/publications/2015/04/maritime-competition-in-a-mature-precision-strike-regime/>; Michael Green, Kathleen Hicks, Mark Cancian, Zack Cooper, John Schaus, et al, "Asia-Pacific Rebalance 2025: Capabilities, Presence, and Partnerships," Center for Strategic and International Studies, January 2016, http://csis.org/files/publication/160119_Green_AsiaPacificRebalance2025_Web_0.pdf.

maritime domain awareness is a good place to start.¹⁹

Japan will continue to be the linchpin of our regional strategy. Prime Minister Shinzo Abe has eased the way by increasing the defense budget, loosening interpretations of the constitution, and passing laws that allow for increased security missions. Last year, Japan signed strategic partnership agreements with Indonesia, Malaysia, the Philippines, and Vietnam. Tokyo has also agreed to give six maritime patrol vessels to Vietnam, sell three to Indonesia, and lend the Philippines money to purchase 10 maritime patrol vessels. Japan is currently bidding to supply Soryu-class submarines to Australia. The door is opening to joint patrols with the US, Vietnam, and Australia in the South China Sea. Japan is becoming a real security provider in the region.

Taiwan is really an opportunity more than a challenge. The democratic island had yet another peaceful election and is undertaking a peaceful transition of power. It is looking to build strong relations with the US and its allies (Japan and the Philippines) and is forging a responsible strategy on its own South China Sea claims. The challenge is how to integrate Taiwan into a common South China Sea strategy against vehement Chinese opposition and our own aversion to risk and change when it comes to the island.

Challenges

US diplomats need strategic guidance and political attention to shape a diplomatic and security order in Asia among countries who gained their independence not long ago and are wary of ceding sovereignty and strategic autonomy. Given Asia's history, the Association of Southeast Asian Nations (ASEAN) will not function as a supranational organization like the European Union (EU) for the foreseeable future, and it will be very difficult for it to negotiate common positions.

China expends tremendous efforts to divide ASEAN or any other regional grouping not dominated by Beijing. I believe that a US-led diplomatic initiative among the allied/partner claimant countries, as well as those with interests in Southeast Asia such as Indonesia, is necessary on a bilateral or trilateral level outside, or complementary to, the ongoing work of ASEAN.

The US should work to achieve as much agreement as possible among the non-Chinese claimants about how to settle South China Sea disputes over rights and territories. The US Secretary of State should be shuttling between Hanoi, Kuala Lumpur, and Manila, while also consulting with Taipei to produce a negotiated settlement. This effort will provide us all with more diplomatic leverage over China. It would also help the US clarify the objectives behind the use of its military power, which should be utilized for continued Freedom of Navigation

¹⁹ Dan Blumenthal, "Networked Asia," *The American Interest*, May 1, 2011, <http://www.the-american-interest.com/2011/05/01/networked-asia/>; Dan Blumenthal, Randall Schriver, Mark Stokes, LC Russell Hsiao, and Michael Mazza, "Asian Alliances in the 21st Century," The Project 2049 Institute, August, 30, 2011, https://project2049.net/documents/Asian_Alliances_21st_Century.pdf; Van Jackson, Mira Rapp-Hooper, Paul Scharre, Harry Krejsa, and CDR Jeff Chism, "Networked Transparency: Constructing a Common Operational Picture of the South China Sea," Center for a New American Security, March 21, 2016.

Operations (FONOPs), as well as to protect agreed upon territory and rights of US allies. I flesh this “shuttle diplomacy” concept out in the *Wall Street Journal* piece cited below.²⁰

The Commission is mandated to make policy recommendations to Congress based on its hearings and other research. What are your recommendations for congressional action related to the topic of your testimony? What role can Congress play in helping to further this component of the Rebalance strategy, and are there specific procurement questions or areas on which Congress should focus more closely going forward?

- 1) Engage in a South China Sea peace initiative that takes the lead in settling disputes among our claimant friends and allies and negotiates common positions on keeping the SCS an open maritime space.
- 2) Increase topline spending, and reverse defense cuts and sequestration. Imagine the change in the conversation we would be having if commanders had the ships they needed to simply execute the various missions they are tasked to do. If these cuts are not reversed, the US will have to change its strategy, possibly significantly, in Asia.
- 3) Assess whether the US is taking on too many risks in other critical regions that affect Asia, and press high-level officials to state publicly how they are meeting global challenges while rebalancing.
- 4) Increase FMF in the Asia-Pacific region and expand the nascent Southeast Asia Maritime Security Initiative beyond \$425 million — security assistance represents one of the best ways to build partner cohesion and alliance capacity. This will require political compromise elsewhere, as the US may have to freeze or reduce FMF levels in other regions. Washington needs a large arms sale in the Philippines, for example, using both FMF and FMS to jumpstart our capacity building.
- 5) Build coalition ISR capabilities.
- 6) Push the executive branch on long-term plans for permanent basing in Southeast Asia.
- 7) More immediately, work with Congress to assess options to deter China from destabilizing responses to the Philippines court case, such as land reclamation at Scarborough Shoal.

Has a proper balance been assigned to each of the major components of the Rebalance—security, economic, and diplomatic—in light of US regional interests, and does the strategy have the right geographic focus? What areas, if applicable, should be given greater weight? Assess the role of the security component within the wider strategy.

I touched on the need for diplomatic activism in the South China Sea. I think the Trans-Pacific Partnership (TPP), while imperfect, would put the US in the economic “driver’s seat” in Asia, and I believe the US needs to expand the trade deal to include South Korea, Taiwan, and whichever Southeast Asian countries are organized and prepared to join.

²⁰ Daniel Blumenthal and Michael Mazza, “A New Diplomacy to Stem Chinese Expansion,” *Wall Street Journal*, June 10, 2015, <http://www.wsj.com/articles/a-new-diplomacy-to-stem-chinese-expansion-1433952079>.

**OPENING STATEMENT OF DR. KATHLEEN H. HICKS
SENIOR VICE PRESIDENT, CHAIR, AND DIRECTOR, INTERNATIONAL
SECURITY PROGRAM, CENTER FOR STRATEGIC AND INTERNATIONAL
STUDIES**

DR. HICKS: Good morning. Thank you to the Commissioners for the opportunity to speak today on my assessment of the defense elements of the U.S. rebalance to the Asia-Pacific region.

My testimony largely draws on my efforts as the co-lead of the 2016 congressionally-directed independent review of the Department of Defense's efforts at rebalance, as well as my prior work inside the Department of Defense working to articulate and implement the rebalance.

In our recently completed study, we reached four main findings about the security situation in the Asia-Pacific. The first two findings concern the need for greater commitment and direction from Washington. The second two address Beijing's growing capabilities and increased appetite for risk.

First, the Obama administration, we find, has not clearly, coherently, and consistently articulated the Rebalance Strategy. Too often U.S. statements have varied in describing the objectives and priorities for the rebalance, confusing even the most careful observers. Without a single overarching strategy document to guide the rebalance, particularly with regard to managing China's rise, this confusion, we believe, will continue.

Second, defense budget cuts have limited the department's ability to implement critical rebalance initiatives. The combination of sequestration and the Budget Control Act leaves the department significantly challenged in confronting the current and projected range of threats. Absent a change in strategic direction and/or an increase in funds to execute the existing defense strategy, the United States will be hard-pressed to promote the rebalance in full while still attending to the security demands present in other regions. The two-year budget deal achieved late last year has helped, but it did not resolve the long-term mismatch of strategy and budgets for defense.

Third, the threat from so-called anti-access/area denial threats is rising. The breadth and pace of A2/AD investments throughout Asia, especially by China, are creating the potential for countries to hold at risk U.S. forward deployed and forward operating forces throughout the Western Pacific.

Regional A2/AD capabilities are evolving more rapidly than the U.S. ability to counter them, requiring the Department of Defense and regional allies to work together if they are to maintain the ability to project power in East Asia.

Fourth, China's tolerance for risk has exceeded most expectations. China has surprised many experts by engaging in a series of coercive actions against neighboring states, including the creation of artificial features in disputed waters of the South China Sea. China's apparent willingness to challenge vital elements of the existing rules-based regional and international order should be of a concern to all U.S. policymakers.

Taken together, these trends suggest that the U.S. rebalance must be enhanced if the United States is to defend its vital interests in the PACOM area of responsibility. In our CSIS report, we make 29 recommendations for improving the defense aspects of the rebalance. Don't worry. I will not review them all. They fall into four broad categories.

First, the United States should align its Asia strategy for internal and external

audiences. We recommend preparing an Asia-Pacific strategic report; increasing administration outreach to Congress through an Asia-Pacific Observers Group; ensuring alignment between rebalance strategy and resources in the next, was formerly called Quadrennial Defense Review, is now known as the Defense Strategic Review; better coordinating U.S. strategy with allies and partners; and expanding confidence building mechanisms and crisis management with China.

Second, the United States should strengthen ally and partner capability. Many allies and partners are struggling to mitigate security risks, particularly those having to do with maritime disputes in the South China Sea and East China Sea. We recommend pursuing what we call federated approaches with highly capable regional allies and building maritime security capacity throughout Southeast Asia, among other initiatives.

Third, the United States should sustain and expand its regional military presence. U.S. military presence serves as a stabilizing force in the region, helping to deter conflict on the Korean Peninsula and managing crises from the South China Sea through the Indian Ocean.

Forward presence provides opportunities for partnership, interoperability, training and exercising with allies and partners that U.S.-based forces cannot easily or cost-effectively sustain. We make a broad set of recommendations to implement and resource key posture initiatives and increase critical American capabilities in the region.

Fourth, and finally, the United States should accelerate development of innovative military capabilities and concepts. Current capability gaps generally fall into two types of areas.

First are those capabilities required to offset an emerging risk to U.S. forces, such as the growing ballistic missile risk to U.S. ships and forward bases, as Mr. Blumenthal referenced.

Second are those capabilities the United States could develop to provide an asymmetric counter to potential regional competitors. Both will be needed for the U.S. military to retain a resilient forward presence and the ability to project combat power into the Asia-Pacific region.

I must stress that the initiatives we put forward are focused almost exclusively on the defense portion of the rebalance. To effect the rebalance, we also need to ensure that complementary diplomatic and economic efforts are underway. This is why our CSIS study team emphasized right up-front the need for an integrated strategic approach in our recommendations.

Thank you for the opportunity to testify, and I look forward to your questions.

**PREPARED STATEMENT OF DR. KATHLEEN H. HICKS
SENIOR VICE PRESIDENT, CHAIR, AND DIRECTOR, INTERNATIONAL
SECURITY PROGRAM, CENTER FOR STRATEGIC AND INTERNATIONAL
STUDIES**

Testimony before the

U.S.-China Economic and Security Review Commission

“Objectives and Future Direction for the Security Component of the Rebalance”

Dr. Kathleen H. Hicks

Senior Vice President for Asia, Henry A. Kissinger Chair, and Director, International Security Program, CSIS

March 31, 2016

Thank you to the Commissioners for the opportunity to testify today on my assessment of the defense elements of the U.S. rebalance to the Asia-Pacific region. My testimony today largely draws on my efforts as the co-lead of the 2016 congressionally-directed independent review of the Department of Defense’s efforts at rebalance as well as my prior work inside the Department of Defense working to articulate and implement the rebalance.

The CSIS Independent Assessment of the Rebalance

In the National Defense Authorization Act of 2015, Congress directed that the Department of Defense solicit an independent organization to assess U.S. strategy and force posture in the Asia-Pacific region, as well as that of U.S. allies and partners. The Department of Defense chose CSIS to conduct that assessment, which we completed in January of this year.

That effort, for which I was a co-lead, brought together contributions from a large number of highly-qualified experts across the range of Asian regional security matters as well as U.S., Chinese, and allied and partner defense capabilities. Research included interviews with leading defense and security officials, experts, and military officers throughout the United States government and foreign capitals. We were further aided by a senior advisor group that reviewed all findings and recommendations of the study prior to its finalization. The report CSIS submitted to the Department reflects the seriousness with which CSIS undertook this assessment as well as the range of challenges and opportunities facing the United States across the Asia-

Pacific region.

Key Findings

The CSIS study team made four main findings about the security situation in the Asia-Pacific. The first two findings concern the need for greater commitment and direction from Washington, the second two findings address Beijing's growing capabilities and increased appetite for risk.

First, the Obama administration has not articulated a clear, coherent, or consistent rebalance strategy, particularly when it comes to managing China's rise. Many U.S. allies and partners in the region are looking to uphold the regional and international order that has enabled so many people throughout Asia to enjoy greater security and prosperity. Yet, too often U.S. statements have listed different objectives and priorities for the rebalance to Asia, confusing even the most careful observers. Without a single strategy document to guide the rebalance, this confusion will continue.

Second, defense budget cuts have limited the Defense Department's ability to implement critical rebalance initiatives. The combination of sequestration and the Budget Control Act, leave the Defense Department insufficient resources, and insufficient flexibility, to prepare for the growing range of challenges confronting the United States. Absent a change in strategic direction and/or sufficient funds to execute the defense strategy that exists, the United States will be hard pressed to promote the rebalance in full while still attending to the security demands present in other regions—from ISIS to Russia. The two-year budget deal achieved late last year has helped, but it did not resolve the long-term mismatch of strategy and budgets for defense.

Third, the threat from so-called anti-access/area denial (A2/AD) threats is rising as some states seek to deny the United States the ability to project power in Asia. The breadth and pace of A2/AD investments throughout Asia, especially by China, are creating the potential for countries to hold at risk U.S. forward deployed and forward operating forces throughout the Western Pacific. Regional A2/AD capabilities are evolving more rapidly than the U.S. ability to counter them, requiring that the Department of Defense and regional allies work together if they are to maintain the ability to project power in East Asia.

Fourth, China's tolerance for risk has exceeded most expectations. China has surprised many experts by engaging in a series of coercive actions against neighboring states, including the creation of artificial features in disputed waters of the South China Sea. China's apparent willingness to challenge vital elements of the existing rules-based regional and international order should be of concern to U.S. policymakers, and to others around the world who believe a rules-based order provides benefits to all.

Taken together these trends suggest that the U.S. rebalance must be enhanced if the United States is to defend its vital interests in the PACOM area of responsibility. Executing an effective Asia strategy will require a clear and consistent but agile approach; continuous dialogue with regional allies, partners, and competitors; robust economic engagement throughout the region; development of new military concepts and capabilities for deterrence, defense, and crisis management; and close cooperation between the executive and legislative branches. We suggest 29 recommendations for doing so.

Main Recommendations

The report's recommendations fall into four key areas, discussed briefly below. Efforts are ongoing in many of these areas and should remain top priorities, but additional efforts are needed in other areas to adequately implement the rebalance.

First, the United States should align Asia strategy within the U.S. government and with allies and partners. Although the Obama administration issued a series of speeches and documents on the rebalance, there remains no central U.S. government document that describes the rebalance strategy and its associated elements. In interviews with leaders throughout the Department of Defense, in various U.S. agencies, on Capitol Hill, and across the Asia-Pacific, the study team heard consistent confusion about the rebalance strategy and concern about its implementation. Indeed, a 2014 study by CSIS found that language used to describe the rebalance has changed substantially since its announcement in 2011. Addressing this confusion will require that the executive branch develop and then articulate a clear and coherent strategy and discuss that strategy with Congress as well as with allies and partners across the world. We recommend preparing an Asia-Pacific strategic report; increasing administration outreach to Congress through an Asia-Pacific Observers Group; ensuring alignment between strategy and resources in the next QDR (now known as the Defense Strategy Review); better coordinating U.S. strategy with allies and partners; and expanding confidence building mechanisms and crisis management with China.

Second, the United States should strengthen ally and partner capability, capacity, resilience, and interoperability. The United States needs robust allies and partners across the Asia-Pacific, but we found growing concern that security challenges are outpacing the capabilities of regional states. Many allies and partners are struggling to mitigate security risks, particularly those having to do with maritime disputes in the South China Sea and East China Sea. The United States seeks and benefits from the success of all states throughout the region, so building ally and partner security capability and capacity is in the U.S. interest. Working together more closely, through coordination of strategic approaches and greater interoperability, is an important step in this direction. Strengthening regional security capability, capacity, resilience, and interoperability requires a differentiated strategy that works with highly capable militaries like Japan, Australia, India, South Korea, and Singapore while also assisting states in Southeast Asia struggling to meet basic defense needs. We recommend pursuing what we call federated approaches with highly capable regional allies; building maritime security capacity in Southeast Asia; forming a standing U.S. joint task force for the Western Pacific; encouraging Japan to establish a joint operations command; and deepening regional whole-of-government humanitarian assistance and disaster relief expertise.

Third, the United States should sustain and expand its regional military presence. We encountered concern both in Washington and in foreign capitals about the sustainability of U.S. military presence throughout the region. Forward-stationed U.S. forces are one of the most important ways to signal U.S. political commitment to the region. The political and military value of forward presence is enormous. U.S. military presence serves as a stabilizing force in the region, helping to deter conflict on the Korean Peninsula and manage crises from the South China Sea through the Indian Ocean. Forward presence provides opportunities for partnership, interoperating, training, and exercising with allies and partners that U.S.-based forces cannot

support. We recommend continuing to implement and resource key posture initiatives; increasing surface fleet presence; improving undersea capacity; deploying additional amphibious lift; continuing to diversify air operating locations; bolstering regional missile defenses; advancing and adapting the U.S. Army's Regionally Aligned Forces concept; addressing logistical challenges; stockpiling critical precision munitions; and enhancing intelligence, surveillance, and reconnaissance cooperation with allies.

Fourth, the United States should accelerate development of innovative capabilities and concepts. We identified capability gaps in two types of areas. First are those capabilities required to offset an emerging risk to U.S. forces, such as the growing ballistic missile risk to U.S. ships and forward bases. Second are those capabilities that the United States could develop to provide an asymmetric counter to potential regional competitors. Both will be needed for the U.S. military to retain a resilient forward presence and the ability to project combat power in the Asia-Pacific, despite competitors' efforts to constrain U.S. leaders by increasing the risk to U.S. forces. Existing concepts and capabilities must be updated to ensure that the future force is capable of deterring and prevailing in potential conflicts. China's development of anti-access/area-denial capabilities aims to restrict U.S., ally, and partner freedom of maneuver. To overcome this challenge, the United States is developing new concepts of operation and next-generation capabilities. However, the security environment is highly dynamic and will require a culture of adaptability, a willingness to try new approaches and risk failure through experimentation, and the ability to move rapidly from concept to acquisition. We recommend institutionalizing a culture of experimentation; encouraging rapid platform evolution; developing advanced long-range missiles; funding innovative missile defense concepts; fielding additional air combat systems; exploiting the U.S. undersea advantage; and augmenting space, cyber, and electronic warfare capabilities.

Many of the efforts described above would require additional resources, as we describe in more detail in the full report. If the United States is to protect its interests in Asia, then meeting these resource challenges should be a top priority for U.S. leaders, both in the administration and in Congress.

Conclusion

The initiatives outlined above are focused on the defense portion of the rebalance, as directed by Section 1059 of the 2015 National Defense Authorization Act. This Commission is also interested in whether the proper balance has been achieved across the major components of the Rebalance—security, economic, and diplomatic. My assessment is that, despite the concerns I have with the ability to achieve the full promise of the defense rebalance with current resources and effort, it has been the most fully developed element of the Administration's rebalance strategy. Passage of a free trade deal for the region that treats American businesses and workers fairly is a key goal for regional security and mutual prosperity. Likewise, a coordinated diplomatic strategy for the region will be important. This is why we have emphasized the need for an integrated strategic approach in our recommendations. Strengthening the rebalance to Asia will require that Washington use all the tools at its disposal if the United States and its allies and partners are to maintain a secure, peaceful, prosperous, and free Asia-Pacific region.

OPENING STATEMENT OF DR. MIRA RAPP-HOOPER
SENIOR FELLOW, ASIA-PACIFIC SECURITY PROGRAM, CENTER FOR A NEW
AMERICAN SECURITY

DR. RAPP-HOOPER: Thank you. Vice Chairman Bartholomew, Senator Talent, and distinguished members of the Commission, I am honored to testify on the objectives and future direction of the security elements of the rebalance.

My testimony will focus on the implementation of the rebalance in and around the South China Sea, and I'll argue that Washington's South China Sea security strategy has focused on diplomatic engagement and military posture changes that are well underway and will bear fruit over time. But Beijing has simultaneously been investing in high-end capabilities for long-term competition and employing an opportunistic strategy focused on quick incremental gains.

In the last 18 months, it has been building islands faster than the United States can build coalitions. The result is a political environment in which Washington is well-positioned to advance its defense interests, which I've laid out in my written testimony in more detail, but China's strategy has shifted the short-term, tactical military balance, and the United States will need to close this gap if it is to dissuade Beijing's near-term challenges to its interests in the South China Sea.

The security component of the rebalance in the South China Sea contains several related lines of diplomatic and military effort. At the core of Washington's approach is the recognition that regional states have deeply complex relationships with China and that a U.S. strategy cannot alienate them if it is to succeed. Through the rebalance's diplomatic initiatives, the United States has overhauled its relationship with ASEAN. It has strengthened bilateral ties with South China Sea claimants, forging comprehensive partnerships with Vietnam, Malaysia and Indonesia, and it's modernized its alliance with the Philippines.

But Washington's strategy, of course, has not been limited to the diplomatic realm. Closer political ties have allowed the United States to strengthen its military posture in and around these waters. New rotational base access agreements with Australia, with Singapore and most recently with the Philippines leave the United States far better positioned to respond swiftly in a crisis, and more access agreements may well follow.

The United States has deployed some of its more advanced assets to the region, increased the tempo of its military exercises, and broadened them to include new partners and missions.

The Pentagon has also made notable strides recently with respect to security assistance, unveiling a \$425 million partner capacity building initiative, which funds five years of aid to South China Sea states, and just ten months into this program, it is already delivering this aid.

These diplomatic and military initiatives have produced real payoffs that would have been quite difficult to imagine just a few years ago. Namely, a political climate that is highly favorable to the United States, one in which partners are eager for more security cooperation and increasingly willing to stand up to China on issues like island militarization and freedom of navigation.

This bodes well for the future of the rebalance. But China's own South China Sea security strategy attempts to preempt or circumvent many of these advances. While Washington has been investing in its longer-term rebalance strategy, China has focused on its unilateral short-term changes to the military balance in addition to its well-known investment in A2/AD

capabilities that both Mr. Blumenthal and Dr. Hicks referenced.

After building 3,000 acres of new land, China is installing military and dual-use equipment on its islands, including surface-to-air missiles in the Paracel Islands and sophisticated radar in the Spratlys.

China's South China Sea strategy has relied on what analysts refer to as "salami slicing" in "grey zones," and this strategy has several features.

First, China's approach relies on opportunism. Beijing has adopted tactics that avoid full-blown conflict and implemented them at times and places when it is unlikely to meet with serious pushback from U.S. forces or security commitments.

China is also the first mover in its efforts to shift the status quo in the South China Sea. Beijing chooses when it will make its next move, and the United States and its partners are forced to respond. Beijing's assertiveness also proceeds in shorter bursts. These characteristics have all been on display in the Spratly Islands where China has dialed up and down its building as its interests suit, and this strategy presents some near-term hurdles for the United States with its rebalance.

The security components of the rebalance are, of course, long-dated efforts, and most of them must be implemented in an incremental fashion. What's more, the political relationships on which all of these advances are based require constant tending, and these are simultaneously great virtues and great challenges. They mean that while the United States is making meaningful progress in rebalance implementation, China has found ways to advance its territorial aims and extend its military reach nonetheless.

The United States should build upon the security achievements of the rebalance to close the gap between its longer-term strategy and Beijing's assertive opportunism in the South China Sea. Washington should draw upon the positive regional political sentiment, strong alliances, and augmented force posture to send clear signals and demonstrate presence.

This approach should seek to dissuade China from seizing new territory or coercing other South China Sea claimants in the coming months and through the presidential transition, and there are several steps the administration and Congress can take to this effect. I offer a few more in my written testimony as well.

First, the United States should clarify its treaty commitment to the Philippines. The United States' alliance with the Philippines dates back to 1951, but it has never stated publicly whether or how this applies to the South China Sea. Using language that already appears in the treaty, top U.S. officials should clarify that the alliance applies to the South China Sea if Philippine forces come under attack, and Secretary of Defense Carter has an opportunity to do so in his April visit to the Philippines.

Second, Washington should coordinate publicly on partner capacity building initiatives with like-minded countries. Security assistance initiatives will indeed take years to bear fruit, but the United States and its partners can begin to reap some of the political benefits much sooner than that.

Japan and Australia are also actively investing in other regional states' capabilities and provide different forms of aid. These three countries should announce some form of trilateral mechanism to coordinate partner capacity building and should also engage with India and South Korea on these issues.

Institutionalized cooperation will send signals of assurance to recipients and will periodically remind China that its opportunistic assertiveness is provoking regional counterbalancing with long-lasting effects.

Third, the Pentagon should go beyond Freedom of Navigation Operations. The United States has resumed FONOPS in the South China Sea, which should be welcomed. FONOPS are really discrete legal signals, however, and are unlikely to change China's calculations by themselves. Washington should conduct more regular presence operations as it did earlier this month when the John C. Stennis strike group transited the South China Sea. It should also conduct regular patrols and surveillance operations in the area from new locations in the Philippines. It should share information with Japan and Australia to this effect, and it should publicly announce that it is doing so.

Finally, as Dr. Hicks and her colleagues have recommended, Washington should report on the rebalance. Precisely because many security elements of the rebalance are long-dated, Washington should produce an annual interagency report detailing the progress made by each agency in each area of the rebalance in the prior year, and it should lay out goals for the next 12 months.

This will make for more coherent messaging to domestic audiences and to allies and ensure that the United States retains strong regional support for its diplomatic and military initiatives.

If the United States hopes to deter Chinese opportunism as it continues to implement the rebalance, it must employ coherent U.S. messaging and visible presence alongside its partners. By drawing upon the diplomatic and military investments it has put in place since 2011, Washington can begin to close the gap between its long-term strategy and China's short-term advances in the South China Sea.

Thanks very much.

**PREPARED STATEMENT OF DR. MIRA RAPP-HOOPER
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AMERICAN SECURITY**

March 31, 2016

Testimony before the U.S.-China Economic and Security Review Commission on “China and the U.S. Rebalance to Asia”

The Rebalance in the South China Sea

Dr. Mira Rapp-Hooper
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Introduction

Vice Chairman Bartholomew, Senator Talent, distinguished members of the Commission, I am honored to testify on the objectives and future direction of the security elements of the Rebalance. My testimony will focus on the implementation of the Rebalance in the South China Sea. I will argue that Washington’s South China Sea security strategy has focused on diplomatic engagement and changes to its military posture that will bear fruit over time. Beijing, on the other hand, has employed an opportunistic strategy focused on quick, incremental gains. In recent years, it has been building islands faster than the United States can build coalitions. The result is that regional political sentiment is quite favorable to the United States, and Washington has great potential to continue shaping the security environment in the next administration. Nonetheless, China’s strategy has shifted the short-term, tactical military balance, and the United States will need to close this strategic gap if it is to dissuade Beijing’s challenges to its interests in the South China Sea.

South China Sea Interests

The United States first articulated its position on the South China Sea in 1995, following a series of incidents between China and the Philippines over Mischief Reef. Washington is not a claimant in these waters, but its stated national interests include the peaceful resolution of disputes, regional peace and stability, neutrality on sovereignty, respect for maritime norms and law including the UN Convention on the Law of the Sea (UNCLOS), and freedom of navigation. This list of principles really serves as shorthand: the United States seeks to uphold the regional order and prevailing rule-of-the-road in the South China Sea. In the last several years, however, Washington has found that these interests are not easy to defend. It is difficult, though not impossible, to draw red lines around a long list of closely-held principles, and Washington would face a serious risk of entrapment if it were to do so. For the purposes of evaluating how the Rebalance advances U.S. interests in these waters, then, it is helpful to consider a narrower list.

The United States has at least three vital national interests in the Asia-Pacific region, all of which are implicated in and around the South China Sea. First are its alliances and the security of its allies. Second is the free flow of commerce, which requires freedom of the seas and skies. Third is the United States’ interest in ensuring that a hostile great power does not dominate the region.

China is, of course, a competitor, but not a full-fledged adversary, and must be engaged through a combination of deterrence, reassurance, and assurance to allies. With its increasingly assertive strategy in and around the South China Sea, however, China is, to varying degrees, challenging all three of these interests.

The U.S.-Philippines alliance is one of Washington's longest standing treaty commitments in Asia, and many of China's activities are taking place near the Philippines' shores. In 2012, Beijing wrested control of Scarborough Shoal from Manila. As the Philippines describes in its current case before The Hague, China has consistently interfered with the Philippines' efforts to extract natural resources from its own waters and to resupply its South China Sea outposts. Most recently, some of China's artificial island building has taken place inside the Philippines' Exclusive Economic Zone (EEZ). Beijing's new runways, ports, and radar give it the capability to operate vessels and aircraft very close to the Philippines, and may use these to put pressure on its outposts, soldiers, and sailors.

China's artificial islands also appear to be placing in jeopardy freedom of navigation and freedom of overflight. Beijing has asserted spurious "military alert zones" around its artificial islands, and has begun to warn away aircraft and vessels that approach. Because many of these island bases are built atop formerly low-lying reefs, they are not legally entitled to territorial waters or airspace under UNCLOS. China has not clarified the nature of the water and airspace claims it is making from the artificial islands and insists that it has never interfered with freedom of navigation. It is true that commercial traffic has not been disrupted, but military traffic certainly has, and this raises concerns that Beijing is challenging freedom of the seas more broadly.

When it comes to the United States' interest in preventing the rise of a hostile hegemon in Asia, China's military buildup in the South China Sea assertiveness does not inspire confidence. Beijing's systematic and widespread changes to the territorial status quo contravene its 2002 Declaration on Conduct with ASEAN, and it has refused to participate in international legal arbitration of maritime disputes with the Philippines. While in Washington in September 2015, President Xi Jinping pledged not to militarize his island outposts, and then proceeded to do precisely that. Yet Beijing and Washington also cooperate on issues of great importance to both powers, from climate change to nuclear non-proliferation. China appears to have calculated that it can challenge the regional security order close to its shores, while still upholding and exercising leadership in global organizations and regimes. To reinforce its own vital regional interests, then, the United States will need to calibrate its security strategy to push back against China's assertiveness where necessary, while simultaneously working with Beijing in other areas. In the previous four years, the security elements of the Rebalance have given Washington some of the tools it needs to do just that.

The Security Rebalance in the South China Sea

The security component of the Rebalance contains several related lines of effort that have evolved over time. These include diplomatic initiatives to deepen existing alliances and build new partnerships and to strengthen U.S. involvement in regional institutions. They also include Washington's steps to augment its military posture and that of its allies through new base access agreements, the deployment of new military assets, and partner capacity building initiatives.

Diplomatic Initiatives in the South China Sea

Washington's diplomatic lines of effort have aimed to build a coalition of support for its South China Sea policies. The U.S. approach recognizes that most states around the South China Sea have complex relationships with China, and that any strategy that alienates them cannot ultimately achieve its ends. Washington's gambit, then, has been a robust effort to harness the power of regional balancing against China's South China Sea assertiveness.

The United States' use of international institutions in South China Sea strategy preceded the Pivot itself. At the 2010 ASEAN Regional Forum, then-Secretary of State Hillary Clinton repudiated Beijing's mounting maritime assertiveness. In the years that have followed, the United States has invested copious diplomatic energy in its relationship with ASEAN through the Rebalance. It has signed the Treaty of Amity and Cooperation, set up the first U.S. mission to ASEAN in Jakarta, sent its first resident Ambassador to ASEAN, and became an active participant in ASEAN institutions, including the ASEAN Defense Ministerial Meetings. This has allowed Washington to work closely with members on regional security issues, including the South China Sea. Through the Rebalance, the United States has also invested in its bilateral ties with other South China Sea claimants, forging Comprehensive Partnerships with Malaysia, Indonesia, and Vietnam and overhauling its alliance with the Philippines.

Washington has also been deeply engaged on South China Sea dispute management. Top U.S. officials have worked with all claimants over several years to encourage them to sign on to agreements to halt land reclamation and militarization so that they may eventually move towards a long-sought Code of Conduct. A binding agreement does not appear to be close at hand, but U.S. investments have helped to convince regional states of Washington's abiding commitment to South China Sea security.

This diplomatic approach has produced real payoffs that would have been hard to imagine several years ago. Until very recently, ASEAN would have been loath to risk alienating China, but in recent statements it has expressed grave concern about China's island building and the fact that it jeopardizes freedom of navigation and freedom of overflight in the region. And despite the fact that many of its member nations retain close economic and even political ties to Beijing, South China Sea claimant states have begun to stand up to China individually, decrying its flight tests of new runways and deployments of weapons systems. Southeast Asian countries are closer than ever to Washington, eager for more security collaboration, and are increasingly wary of Beijing's longer-term intentions.

Defense Initiatives in the South China Sea

Washington's strategy has not been limited to the diplomatic realm: closer political ties have allowed the United States to strengthen its military posture around the South China Sea through basing agreements, the deployment of new assets, and partner capacity building efforts.

First, the United States has concluded several new rotational base access agreements that augment its South China Sea force posture. The U.S.-Australia Force Posture Agreement has established the rotational presence of U.S. Marines in Darwin and in Northern Australia. Washington and Canberra continue to discuss follow-on access agreements. Singapore has

agreed to host four Littoral Combat Ships and a P-8 surveillance aircraft. In a recent success, the Philippines Supreme Court approved the 2014 Enhanced Defense Cooperation Agreement (EDCA). Manila has already announced that it will grant Washington rotational access to five bases in the Philippines, with additional sites likely to come.

These rotational access agreements meet U.S. force posture goals of geographic distribution, operational resilience, and political sustainability and more agreements may follow in the coming years. U.S. officials have signaled that they would like to discuss with Vietnam rotational access to Cam Ranh Bay, for example.

The United States has also deployed advanced assets to Asia as part of the Rebalance. This includes Virginia-class attack submarines, P-8 surveillance aircraft, F-22 and F-35 fighters, B-52 and B-2 bombers, Aegis missile defense-equipped vessels, Littoral Combat Ships, and will include the new Zumwalt stealth destroyer. Further, the United States has increased the tempo of its military exercises and broadened them to include new partners and new missions.

Partner Capacity Building

The United States has also made strides in the area of security assistance. Until 2015, the PACOM Area of Responsibility received just one percent of Foreign Military Financing. The Pentagon's \$425 million Maritime Security Initiative (MSI) funds five years of partner capacity building for the Philippines, Vietnam, Indonesia, Malaysia, and Thailand. The Maritime Security Initiative is primarily focused on helping partners to build their maritime domain awareness capabilities so that they can better provide for their own security. It will also provide training and maintenance assistance to recipient countries. Just 10 months after Secretary Carter announced the initiative, the first \$50 million of funding to partners was authorized, and this amount will increase in the coming years.

The Near-Term Challenge of Long-Term Strategic Investments

The diplomatic and military components of the Rebalance in and around the South China Sea are long-dated efforts. Since 2011, the United States has made meaningful upgrades to its regional security posture, but these are nonetheless incremental in nature, and the political relationships that accompany them require constant tending. These are simultaneously great virtues and fundamental challenges for U.S. strategy.

Rotational base access is lower cost and relatively easier to secure than permanent basing, but may still take years to establish, as demonstrated by EDCA. It also likely means a relatively lighter military footprint. The United States is unlikely to station numerous major surface combatants at a base it does not own and could be asked to vacate on short notice. Washington has sent some of its newest and most sophisticated military assets to the region, but with flat defense budgets, the Budget Control Act still in place, and ship numbers in decline, these new deployments will reinforce but will not revolutionize U.S. presence.

Partner capacity building in Asia is also a valuable endeavor, but most Southeast Asian partners are beginning from a low baseline, and countries like the Philippines are unlikely to build robust coast guards and navies from nothing. The United States does not have longstanding defense ties with most MSI-designated countries and it will take time for them to learn to work together

efficiently and effectively. It also remains to be seen how partners will absorb the foreign military aid they receive. Moreover, partner capacity building is designed to be a long-term initiative, and will take several years worth of financial, technological, and political investments to bear fruit.

In its first four years, the security component of the Rebalance has produced meaningful changes in U.S. alliances, institutional ties, force posture, deployments, and security assistance, with the promise of more to come. China's own South China Sea strategy, however, attempts to preempt and circumvent many of these advances.

China's Strategy in the South China Sea

While Washington has been investing in its longer-term strategy, China has focused on unilateral short-term changes to the military balance in the South China Sea. Beijing built 3,000 acres of new South China Sea land over a period of just 18 months, and has been paving three new runways in the Spratly Islands with breakneck speed. Despite President Xi's assurances to the contrary, China is clearly installing military and dual-use equipment on its islands, including surface-to-air missiles in the Paracel Islands and sophisticated radar in the Spratlys. More problematic than the installations themselves is the fact that China claims they are not militarily provocative at all. If Beijing believes these systems are purely defensive, however, it is safe to assume that more dangerous deployments will soon follow.

Over the last few years, China's South China Sea strategy has relied on what strategists refer to as "salami slicing" in "grey zones." Beijing has advanced its interests opportunistically and incrementally, keeping its activities below the threshold of open conflict that would provoke intervention by the United States. China has moved an oil rig into waters disputed with Vietnam, wrested the Scarborough Shoal from the Philippines, and dredged up seven artificial Spratly Islands. These activities have all provoked collective outcry but little active response because Beijing possesses several key advantages.

First, China's South China Sea approach relies on opportunism. Beijing has adopted tactics that avoid full-blown conflict and implemented them at times and places when it is unlikely to be met with serious pushback. China is also the first-mover in its efforts to shift the status quo in the South China Sea, although Chinese officials would almost certainly disagree with this characterization. Beijing chooses when it will make its next South China Sea move, and the United States and its partners are forced to react. The tempo of its activities also provide China with an advantage: unlike U.S. diplomatic or military efforts which have long time horizons, Beijing's assertiveness proceeds in shorter bursts.

These three characteristics have all been on display in the Spratly Islands, where China reclaimed new land incredibly quickly, and has then dialed up and down its building as its interests and the international environment suit. Salami-slicing has produced significant gains for Beijing, although they have come with diplomatic and reputational costs.

With its recent deployments of missiles and radar, however, China has moved beyond this grey area. Analysts have long worried that China is developing an anti-access/area denial (A2/AD) capability that aims to keep foreign powers from entering or operating in the waters close to its

shores in the event of a major conflict. To implement this approach, China would need sophisticated radar to monitor the area and surface-to-air and anti-ship cruise missiles to ward off outside powers. The two surface-to-air batteries that China has recently rolled out will surely not keep the United States away, but chances are good that these will not be the last, and Washington and its partners need no longer ponder China's intentions for its island outposts.

Recalibrating U.S. Strategy through the Rebalance

The United States should build upon the diplomatic and military achievements of the Rebalance to close the gap between its longer-term strategy and Beijing's assertive opportunism in the South China Sea. Washington should draw upon positive regional political sentiment, strong alliances, and improved force posture to send clear signals and demonstrate presence and should aim to dissuade China from seizing new territory or coercing other claimants in the coming months. This will be particularly important following the Permanent Court of Arbitration's decision in the *Philippines vs. China* case, which is expected this spring and is likely to spark regional tensions. There are several steps that the administration and Congress can take to this effect.

Clarify Treaty Commitment to the Philippines. The United States' alliance with the Philippines dates back to 1951, but Washington has never clarified publicly whether or how this applies to the South China Sea. This stands in sharp contrast to Article V of the U.S.-Japan Treaty, which Washington applies to the Senkaku Islands by virtue of the fact that Japan administers them. The Senkakus have a different historical role in the U.S.-Japan alliance than any of the territories the Philippines occupies in the Spratlys. The United States can nonetheless update its declaratory policy to make clear that its vital interests will be implicated if China uses force against the Philippines in the South China Sea. The existing mutual defense treaty pledges U.S. defensive aid if Manila's "armed forces, public vessels or aircraft" are attacked. U.S. leaders do not repeat this phrase in official statements nor have they stated where this clause applies, but the time has come to remove some of this ambiguity. Washington should state that the U.S.-Philippines mutual defense treaty applies to Philippine forces operating in the South China Sea. Secretary of Defense Ashton Carter has an opportunity to do so during his upcoming visit to the Philippines.

Coordinate Publicly on Partner Capacity Building. Security aid to countries like the Philippines and Vietnam may be long-dated initiatives, but the United States and like-minded countries can begin to reap some political benefits sooner. Japan and Australia are also actively investing in other regional states' capabilities and provide different forms of aid. The U.S. and its allies must ensure that this assistance is complimentary. The three countries should announce a trilateral mechanism to coordinate partner capacity building. Institutionalized cooperation will send signals of assurance to recipients, and will periodically remind China that its opportunistic assertiveness is provoking regional counterbalancing with long-lasting effects.

FONOPS and Beyond. In October, the United States resumed Freedom of Navigation Operations (FONOPS) in the South China Sea, and the administration has pledged to conduct them routinely. This should be welcomed. Despite the recent publicity surrounding them, however, FONOPS are really discrete legal signals and are unlikely by themselves to change China's calculations about seizing new territory or coercing other claimants. Washington should conduct more regular presence operations to make its commitment visible, as when the John C.

Stennis strike group transited the South China Sea in early March. With new rotational base access in the Philippines, it should also conduct more regular patrols in the area, share information with Japan and Australia, who conduct similar operations, and publicly announce that it is doing so.

Regular Reporting on South China Sea Operations. FONOPS may now be conducted more frequently, but the Freedom of Navigation program still reports on them just once a year. Moreover, FON reports disclose the name of the country whose claims were challenged, but do not document which of these assertions occurred in the South China Sea, nor do they document the legal challenge made by each operation (a prior notification of innocent passage requirement, spurious claim to a territorial sea, etc.). FONOPs should occur regularly and without fanfare. A more detailed, quarterly report will allow the Pentagon to conduct the operations in this manner, while ensuring that Congress and other stakeholders at home and abroad are informed of its activities.

Report on the Rebalance. Precisely because many security elements of the Rebalance are long-dated and because their composition has evolved with time, Washington should produce an annual interagency report. The report should document the progress made by each agency in each area of the Rebalance in the prior year and should lay out goals for the next 12 months. This will make for more coherent messaging to domestic audiences and to allies and ensure that the United States retains strong regional support for the diplomatic and military aspects of the initiative that it has built since 2011.

If the United States hopes to deter further Chinese opportunism in the coming months, it must employ coherent U.S. messaging and visible presence alongside its partners. By drawing upon the diplomatic and military investments it has put in place through the security component of the Rebalance, Washington can begin to close the gap between its long-term strategy and China's short-term advances in the South China Sea.

PANEL I QUESTION AND ANSWER

VICE CHAIRMAN BARTHOLOMEW: Thank you very much for interesting testimony from all of you.

We'll go ahead and start with questions. Dr. Wortzel.

COMMISSIONER WORTZEL: Thank you, all, for the testimony.

I have really two sets of questions. The first I think primarily for Dr. Rapp-Hooper and Mr. Blumenthal, but anybody can comment. What good do presence operations do us? In other words, you could put two carrier battlegroups into the South China Sea, and the Chinese are still reclaiming land, and how does that presence stop us or stop them from beginning reclamation in Scarborough? Should we actually help the Philippines resolve Second Thomas Shoal and the Sierra Madre by helping them reclaim?

And then, Dr. Hicks, I wanted to ask you--I guess its pages 79 through 82 of your report--you deal with Thailand in there. Those three pages deal with Thailand and how IMET has been suspended; FMF has been suspended. We had a very rich military relationship with Thailand. It kind of reminds me of what we did with Indonesia, and in Thailand, it's not even about murdering a lot of innocent civilians, you know, yeah, it was a coup, probably the fifth there in a few years. But we didn't do anything in Egypt when el-Sisi ran a coup. I don't think we even called it a coup.

So Egypt is currently getting 1.3 billion in FMF funds. Thailand gets nothing, and they're literally a client of China. How do we address that?

DR. HICKS: Okay. I'll jump on the second one while they think about the first one. First of all, you are correct on the Sisi comparison that it was not called a coup, but I would say there were, just for point of fact, there was a suspension of U.S. aid for some time, which as you point out has now resumed.

Overall I would say, as in all things, the United States government, of which I am not a member, is constantly trying to weigh how to bring forward the right set of values in its foreign policy with the practicality of sort of the realpolitik interests, but keeping in mind that there is a long-term effect to being too realpolitik that can blow back.

With regard to IMET, though, I do--so I'm not going to attempt to resolve that here. With regard to IMET, I will say that I very much believe that it is a poor tool to stop and start because its goal is to bring about closer relationships and professionalism of military forces that are intended to be a force for good. Part of that IMET training is about professionalism, is about human rights. We've done this before with Pakistan. You point to Indonesia. I have yet to see an example where suspending IMET has helped us, let alone that it has hurt us essentially in many cases that I can think of. So I think it's a poor mechanism to use, and I do suspect as we creep forward in the U.S.-Thailand relationship, that is one of the elements that the Department of Defense is probably seeking to have reinstated.

DR. RAPP-HOOPER: Thanks so much for a great set of questions.

You, of course, bring up a very difficult problem that strategists have to think about, which is the fact that deterrence is extremely hard to measure. When we think about presence operations in the South China Sea or anywhere, there's a fundamental assumption that U.S. presence is going to deter or dissuade a potential challenger from taking an action that we do not want it to take. In this case, you are referring to China potentially as expanding the scope of its activities in the South China Sea.

I do think that U.S. presence in the form of a John C. Stennis strike group or other major surface combatants does remind China that the United States is within sailing distance

regularly and prepared to come to the aid of its allies, namely the Philippines, but the reason that this is meaningful is because there is, of course, the risk that China will expand its activities beyond what it has already been doing.

To your question about whether a presence operation would necessarily deter China from continuing reclamation activity, let's say, at a location where it has already done so, no, I don't think there's a lot of reason to believe that it would.

But if we were to consider some of the other examples you brought up, for example, activity at Scarborough Shoal or Second Thomas Shoal, I do think there are actually qualitatively very different propositions, and those are activities that the United States should seek to dissuade.

Those activities are different because they involve outposts that China did not previously occupy, and the eight sites where it has conducted land reclamation thus far are outposts that were already in China's possession. But China did take the Scarborough Shoal from the Philippines in 2012 and putting pressure on the Second Thomas Shoal would, again, constitute a form of escalation.

So I do not think that presence operations by themselves are likely to arrest all manner of Chinese activities, but a combination of diplomatic signaling by the United States on behalf of interests such as close allies like the Philippines and presence can remind China that broadening the scope of its activities may well be considered emasculation by the United States as well as its partners in the South China Sea.

MR. BLUMENTHAL: Yes. I agree with a lot of that, and, as you know, Dr. Wortzel, the deterrence with China, I mean as deterrence with anyone, is going to be what can we hold of theirs that they value, and while we may or may not be able to deter specific acts of land reclamation, and that's going to depend on how important those acts are to us. So, as Dr. Rapp-Hooper said, clarifying the Philippine alliance obligations gives us a political framework in which to say, well, this is pretty important, that this particular shoal is pretty important, which is why I'd like some more diplomatic clarity and diplomatic activity.

But in terms of what China values the most, I mean one of the things it fears the most, as you know, is, is this very balancing coalition that we're describing here. And let's not forget that Taiwan is also a claimant in the South China Sea, and we are under obligation, legislative obligation, to also defend Taiwan. But, you know, we also have this relationship with Taiwan where we're going to have to figure out anyway how to include it in discussions relating to South China Sea disputes and, again, if you go back to the issue of what deters China, what do they not want to happen, we can make those things happen, and we can threaten to make those happen, and in my view, that's how deterrence works.

VICE CHAIRMAN BARTHOLOMEW: All right. Thank you.
Chairman Shea.

CHAIRMAN SHEA: Thank you very much. Great to see you, Dan.

We're the Economic and Security Review Commission so I'm going to ask a big picture question about economics and security. And as I see it, Chinese economic growth is powering its military growth and modernization. And this growing military, in turn, is sort of a fire that's lighting the rebalance, our reaction to it.

Now, Dan, in your testimony, you talk about how the U.S. has created a system that has greatly benefited China economically, and then you say the U.S. has pursued a strategy of primacy across Eurasia, and one of our interests is preserving and continuing to refine the liberal international order consistent with the U.S. way of life.

Now if I'm sitting in Beijing, and our economy is exceeding that of the United States, maybe one-and-a-half times that of the United States eventually, this notion that we should preserve the U.S. way of life in its own neighborhood is something, if I were Chinese, I would probably just disagree with.

So my question is should we be encouraging greater U.S.-China economic integration when, in fact, that integration is powering the economy, helping to support an economy that's supporting a military that we're rebalancing against? Or is the notion that we should just sort of wait it out, the Chinese economy is full of contradictions, it misallocates capital, it's got this demographic time bomb, its population is becoming older, it's going to be caught in this middle income trap, and we just sort of be tough now, wait it out?

Help me think about these questions and tell me if I'm stupid as well.

MR. BLUMENTHAL: You're not stupid.

[Laughter.]

MR. BLUMENTHAL: You're very smart. Those are a tough set of questions. When I say from a U.S. strategist's point of view what we were trying to do since the end of the Pacific war, and that is not only to defend ourselves forward but to shape an order that is consistent with our prosperity and our liberties and so on, and our security, so that doesn't necessarily--you know, we weren't mostly creating that order to help others. We were doing it to help ourselves with some enlightened self-interests.

But I take your point that if I was China, I'd probably be doing what they're doing. I would be benefiting from the international economic order and the public goods provided by the United States and the maritime commons and then building my own military, and I would also see the kinds of things we're talking about here, which is posturing and the way we're posturing and building relationships around my maritime periphery, as very threatening, and so I would build up coercive military power, but I'm a hawk in China and I'm a hawk in the United States. So that's what I would do.

In terms of your larger question, I guess, let me answer it this way. I think something we all need to think about as policymakers, as the Congress, as the Commission, is that this linear path of booming economic growth in China is going to come--is coming to an end, and it's still going to be powerful, but I think for the next ten, 15 years, unless there is major economic reform, which I don't foresee in China, it's going to be a China growing much more slowly without kind of the same buzz it has about these dizzying rates of economic growth.

And the question for us I think is not whether or not to continue integrating. Some of those questions are going to be up to China whether they want to keep integrating or not, the question is what hedge strategy do we have for a China that is not growing as fast, that is internally unstable but still powerful? How are they going to act and how does this rebalance strategy meet our objectives in that context?

DR. HICKS: If I may, you know, I think it's an important question, and I think it gets to the heart of how we feel about the role of China in the future. My strategic assessment is it's better to have a capable, economically sound China that's a really big market for the United States and an enlightened self-interest to have a stable East Asia and then broader Asia-Pacific region.

We have to acknowledge that there are elements of competition that are built into the two great powers operating in a confined area that happens to be closer to the homeland of one than the other, and that's inevitable. We need to work on that tension, and I think we do that by ensuring we can demonstrate our ability to protect the importance of our alliances, to protect

those alliances, and to be able to ensure that free flow of goods can't be held hostage.

But that does not mean that it is against our interests to continue to help China realize the advantages of the current system in which it is operating. We don't want them to think that developing an alternative international economic system is to their advantage. We want them to see that the current system advantages them.

CHAIRMAN SHEA: Okay. Thank you.

Ms. Rapp-Hooper.

DR. RAPP-HOOPER: I'll just add one quick comment onto that. At the heart of your important question was a large question about the liberal international order writ large, which, of course, Mr. Blumenthal raised in his testimony.

I think something that we've learned over the last several years is that we're not going to get one singular answer to the way that China intends to engage with the liberal international order writ large. For many years, we've sort of asked the question of whether China will be a responsible stakeholder, whether it will join the community of nations as it rises, but what we've seen over the course of this administration is certainly as we've implemented the rebalance is that China can provide different answers to that question in different domains.

So close to its shores, China appears to be challenging what we might call the liberal international order in the form of the U.N. Convention on the Law of the Sea and other international regimes, while simultaneously acting as a very good and responsible partner on other global issues such as climate change or Iran's nuclear program, for example.

In economic issues, it may be seeking to create alternative arrangements or write some new rules of the road on its own, but what this all demonstrates to us is that there's not going to be one writ large answer or easy solution to what both the security and economic questions that are posed by China's rise mean for the United States. Rather we have to be prepared to engage China nimbly and in a very nuanced manner across different domains, accepting that there will be conflict in differing levels and in different forms in each one of those domains.

CHAIRMAN SHEA: Well, I hope we're capable of doing that as a government.

DR. RAPP-HOOPER: Yes.

CHAIRMAN SHEA: Thank you.

VICE CHAIRMAN BARTHOLOMEW: Great. Senator Talent.

HEARING CO-CHAIR TALENT: Thank you.

I think Dr. Rapp-Hooper suggests in her testimony that the United States clarify its commitment to the Philippines. If any of you disagree with that, would you say so because I'm thinking that might be a pretty good recommendation. It's not really a question to discuss unless one of you disagrees.

Dr. Hicks, you said that the administration had been at times confusing and contradictory about its objectives with the rebalance. So my first question--I'll just give the questions and then you all can answer--that wasn't my impression. I mean my sense is that they've been reasonably clear that they want the norms of international behavior observed, peaceful resolution of disputes, et cetera. The object has been pretty clear. My concern has been whether we've had the power to back it up.

Dr. Rapp-Hooper, you just said that the Chinese--we're not certain how they're going to engage the international order because sometimes when they're far away from their shores, they act like a good actor, and when they're close, they're acting like a hegemon, but isn't the unifying thing in both instances that they're pursuing their own interests? So when they think

it's in their interests to appear to be a good international actor, they would, and otherwise they won't.

DR. RAPP-HOOPER: [Nods affirmatively.]

HEARING CO-CHAIR TALENT: And, then, finally if there's time, I'm very intrigued by Mr. Blumenthal's suggestion that United States take an active role in trying to resolve the disputes between the claimants in the South China Sea, and then I presume, Dan, with a view towards guaranteeing or recognizing, I guess I should say, whatever resolution comes out of that. If you'd take a minute and discuss that, I'd appreciate it, assuming we have time.

DR. HICKS: I'll start on the first question. If the issue is specific to the South China Sea, I think that's the place where the administration has been most clear. There are some differences between officials over time, but in general, there and on the Senkakus I think the U.S. government has kept its language relatively tight.

If it's about the rebalance, it's much looser. Whether it was the original Pacific pivot article in Foreign Affairs that then morphed into rebalance because of the pushback, and Dan referenced this a little bit, sort of whether, whether we were pivoting away from other countries. So the changing, adapting over time. To some extent that's inevitable. But it didn't change and adapt consistently and wholly particularly across different department leaders. So the president might have one set of talking points, the Secretary of State a different, Secretary of Defense a different, and they weren't--they were at times clashing.

So clear cases in point. To what extent is the rebalance really about China and security? To what extent is the rebalance really about the U.S. economic future and its relationship to Asia, the importance of maintaining peace and security in Asia, in order to ensure our economic future? To what extent does the rebalance have to do with North Korea? North Korea tends to get very lost in the discussion of rebalance. We almost always talk entirely about China when we think of rebalance, even on the security side of it.

And so for the defense community, it becomes confusing about is this about things like air-sea battle and naval and air power, and/or is it about ground combat capabilities, one necessarily losing out to the other in the rebalance?

So bottom line, I think there has been quite a bit of confusion. The approach has been to articulate the rebalance speech by speech by each different, again, usually department head, and I think that has created more confusion, particularly for our allies. It does create confusion inside USG, but I would say it's very notable if you talk to allies when they are in town or when you're traveling overseas, and they're attempting to read every speech and understand nuances that maybe weren't even intended to be there, that a more presidentially approved strategic guidance document would help clarify.

DR. RAPP-HOOPER: Senator Talent, you raise a good question, and I think the simple answer is, yes, I think we know that China is an interest-based actor, as are many states in the international system, in particular great powers. But a question that derives from that is what are the implications of that?

Obviously, if we know that China maintains the ability and interests to act differently in different domains, this suggests that U.S. policy, certainly through the rebalance and elsewhere, should aim to shape China's choices wherever possible. So on questions like North Korea, that means asking of ourselves and putting centrally--putting at the center of our policy how we shape China's choices with respect to North Korea and its nuclear weapons program.

The same question certainly also applies in the economic realm where, as Dr. Hicks mentioned, China may be seeking to build alternative institutions and create an alternative economic framework.

But I think it also has implications for the way that we think about our own policy with respect to treating China as an interest-based actor. Namely, we should not necessarily assume that we can buy off China in one area by making concessions in another area. We should accept that, like the United States, China is going to pursue its natural interests across domains to the best of its ability.

But that means that, for example, making concessions on the South China Sea won't necessarily produce a better policy on North Korea, and that's something to consider seriously as we pursue the future implementation of the rebalance and move into a new administration.

HEARING CO-CHAIR TALENT: See, I agree with what you just said. I understood you originally as saying that there are certain contexts in which China acts or is the responsible state actor because they think that's the right thing to do even if it's not in their interests, and I don't agree with that.

If what you're saying is there are some times when they see it in their interests to be a responsible state actor, then I, then I do agree, and I think that's how you clarified it.

DR. RAPP-HOOPER: Yes, that is my intention, and indeed I do think it's in China's interests to cooperate on climate change, on Iran's nuclear program, et cetera. This is not altruism. That is also interest-based action.

HEARING CO-CHAIR TALENT: I see I'm out of time. If we have a round two, I am going to ask you to discuss Mr. Blumenthal's idea because I think it's very intriguing.

Thank you, Madam Chairman.

VICE CHAIRMAN BARTHOLOMEW: Thanks.

Commissioner Wessel.

COMMISSIONER WESSEL: Thank you all, and good to see you back before us Mr. Blumenthal. I'm glad you prefer to be on that side. I'd love to have you back on this side.

We're going through a campaign right now where China is getting a lot of attention, and our report will be coming out in November right after the election so not asking for any prophecies, et cetera.

But as I look at this and hear what you're saying, it seems to me that there need to be some more bright line tests as to what is acceptable behavior and what is not. You know, China, as we've all talked about, will do what is in its interests. We just talked about climate change, Iran, et cetera. And there has been little or no cost to them for the activities that they have been pursuing which we don't view as in our interests.

We sanctioned them on ZTE, and a week later we revoked those for a period of time. They continue to reclaim land and build up facilities despite our saying and believing that we had an agreement not to do that. What are some of the bright line tests that you think that-- validating the treaty is one. What other bright line tests do you think Congress should be looking at as to where China has gone too far and reactions should be swift and sure?

Dan, you want to start?

MR. BLUMENTHAL: Tests where China crosses lines?

COMMISSIONER WESSEL: Our lines appear to be somewhat negotiable or soft right now. Sure, we have our battlegroups going through, but they continue to--

MR. BLUMENTHAL: Yeah.

COMMISSIONER WESSEL: --advance their own interests--the salami or baloney slicing.

MR. BLUMENTHAL: Right.

COMMISSIONER WESSEL: I don't see that they're not pursuing all of the activities they would be pursuing otherwise.

MR. BLUMENTHAL: Right. I mean I think we should assume they will in the absence of the kinds of pushback I think we're all getting at in different ways. The costs at the end of the day are to the Chinese are these changes in posture, these closer alliances. These are suggestions. I guess what I'd say is they're already crossing lines.

COMMISSIONER WESSEL: Right.

MR. BLUMENTHAL: And so the pushback we're in discussion, I think a little bit of pushback, you know, the tightening of alliances, the clarification on the Philippines, the clarifications on what the Scarborough Shoal means, and I think there's a whole tool kit of things that one can do to deter that specific activity starting with clarifying our alliances and how our obligations fit into the South China Sea with respect to the Philippines.

But there's other things one can do as well, from financially sanctioning certain dredging companies, as Dr. Hicks' colleague has suggested, to other things. I think there is some utility in defining not so much our bottom lines but our very clear national interests, and one of those is, of course, to keep the South China Sea as a peaceful maritime commons.

The second one I think is to make sure that our allies and new partners don't lose their maritime rights and their maritime territories while they're in discussions about a code of conduct. And I think we got to be clear about that, and from that flow all kinds of economic statecraft tools that we have, posture statecraft, political warfare statecraft types of issues, that we need to begin right now I think to continue to push forward.

COMMISSIONER WESSEL: Others?

DR. RAPP-HOOPER: I agree with much of what Mr. Blumenthal has laid out. Of course, when one thinks of drawing bright lines, as you put it, we have to acknowledge both that such bright lines allow us to make clearer deterrent threats, but they also inherently invoke credibility. So anywhere we draw a red line or a bright line, we have to be very much prepared to follow through on it. I think--

COMMISSIONER WESSEL: Do you believe that what we have been doing has been credible?

DR. RAPP-HOOPER: I think it depends what you're referring to when you say what we've been doing. I think there are some issues that are inherently involved in defending the list of national interests that the United States currently articulates with respect to the South China Sea in particular.

So when we speak about our interests in the South China Sea, we talk about things like the peaceful resolution of disputes and international law, all of which are very laudable and important principles that we do hold dear, but they're very difficult principles around which to create a deterrence calculation although not impossible. So I think it would have been a little bit too much to hope that a presence operation would deter China from impinging upon international law because the signal is not necessarily tied to that very lofty interest.

So that comes back to your question about whether we need to draw clearer lines around what are fundamentally our international interests in the South China Sea? This is why I have suggested clarifying the treaty commitment to the Philippines because I do think that allies

and alliances are amongst our most vital core interests in the South China Sea.

I also think that another clearer line that this and a new administration might consider drawing has to do with any further territorial expansion. I don't think we should accept in any way as legitimate the new islands that China has built on tops of reefs or rocks, but neither would we or other countries in the region accept any new efforts by China to conduct land reclamation or otherwise develop additional outposts in the South China Sea.

There's an existing regional basis to oppose that type of action, and that is the 2002 ASEAN Declaration on Conduct. The parties to that agreement agreed not to change the status quo in the South China Sea and any further territorial expansion by China in that area would do exactly that. So I think that's another interest that we could state and that allies and friends in the region would very much support.

MR. BLUMENTHAL: It's one thing to reclaim land and put some military territories on it, but it's not sovereign Chinese territory, and that's very important when we think about our various options, military and otherwise. And you can render what they've done useless diplomatically and useless militarily if you wanted to, but I think a clarity of what your national security interests are is important first.

VICE CHAIRMAN BARTHOLOMEW: Great. Okay. Commissioner Fiedler.

COMMISSIONER FIEDLER: I've got a couple of questions. One, well, let me make a comment first. Much of the context that we're talking about in fact is less about hardware than it is about calculations of will, in my experience, and we haven't talked at all this morning about Chinese motivations for its actions and our perception of where they are going. In other words, what's next? So I'd like somebody to address that from the Chinese side.

And I'm not sure we understand the internal decision-making process behind their actions, i.e., is it simply part of Xi's consolidation of power for domestic purposes? Is it to gain control of the military by satisfying some of their appetites for assertiveness? What is motivating it? And then the ultimate question for our rebalance strategy, it seems to me, is when does rebalance become containment, which is the sort of elephant in the room, it seems to me, from the Chinese perception point of view?

DR. HICKS: Let me jump in on that. Particularly as a defense analyst for most of my life, I often answer the question you ask as follows, which is I can't begin to assume I'll be correct about the intentions, so I have to deal with the facts. And in the defense realm, the facts are that the Chinese are growing their military capabilities at an alarming rate. The fact is land reclamation has picked up in the last few years at an alarming rate, to include the installation of radars, other facilities, et cetera, and even statements that they have military, a military relationship or cause.

So that's kind of the first level. We have to make sure that we are thinking through the implications of those capabilities for the interests, which I think this panel has done, particularly my co-panelists have done a very good job coming back to repeatedly, that are essentially enduring.

And with regard to freedom of navigation, rule of law, freedom of the airways, as well, with regard to our alliances with whom we have treaty--you know, these are countries with whom we have treaty commitments, that draws immediately in the credibility of the United States. And also with regard to our economic prosperity, another enduring interest of the United States.

So we have to look at the capabilities that are extant and projected and what the implications are for those capabilities. Now, this, I'm going to jump all the way to your last

point, which I think is exactly right, at what point does focusing just that way, if we were to only do that, cause us to go into an approach that is essentially viewed as containment?

I do think that's something we have to be careful about and watch. At least in government that was something we thought about quite regularly. What were, for instance, opportunities presented to the United States because the Chinese are acting ham-handedly and handing us people who want to provide us access, for instance? That's fantastic. But at what point do we use our own best judgment to ensure that we are not creating situations that could cause miscalculation based on a view that the U.S. is, in fact, trying more to encircle, in the Chinese viewpoint, than to simply balance and ensure that we can pursue those vital interests?

So I think it's a very important question. I think it's probably the most important question on the security side as we move forward. There is an impetus to take all the advantage you can right now while the Chinese are making it really easy for us, but we have to be thinking long-term about the cycle that that might create, and I think we will have to, while still always thinking about those capabilities and how we have to counter them, think about the way in which we do it, that we are signaling as effectively as possible what--that we are sticking to those interests that we have described and don't have a more hegemonic intention with regard to China.

MR. BLUMENTHAL: You know the problem with containment is that China uses the word as a part of their propaganda and political warfare aimed at the Southeast Asians. So any time we want to do something in our own interests or in the Southeast Asian interests, the Chinese will propagate from their Political Warfare Department that this is containment and to scare off Southeast Asians and others who lived through containment in the Soviet era, don't want that, and so on. That's the biggest problem I see with containment.

Obviously, when we're talking about stopping the territorial expansion of China, there's some containment going on. The Chinese are trying to contain us as well, but there's a lot of engagement, and there's a lot of integration. Containment has this particular Cold War kind of hue to it where so many competitions, rivalries and so on had so many different elements of the relationship, and I think that's the case with China as well.

We could and should widen the aperture in terms of other places that we might want to affect China's calculations, hold things of value in terms of where they look on the continent of Asia and so on. You know there's ways you can compete better and impose more costs than we're doing right now, but I think containment plays right into the Chinese political warfare attempt to cut allies off of cooperating at all.

DR. RAPP-HOOPER: On the question of where China is going, I'll take a similar response to Dr. Hicks and say that I'm not a Chinese domestic politics expert, but it is important to remember that in many of the places where China has been placing pressure in the last several years, the East China Sea, the South China Sea, these are areas where China genuinely believes itself to have sovereign territorial claims. So the military development is absolutely alarming, as Dr. Hicks said. The pace of land reclamation was just absolutely breakneck.

But China does not believe itself to have sovereign territorial claims everywhere. The geographic scope is the East China Sea and the South China Sea, and then, as it has always been, Taiwan. So we should consider these three areas to be serious risks for future potential flashpoints, but to recognize that this is based on Chinese perceptions of their own sovereign claims.

To this important question about containment, I do think it's important that we press forward with initiatives, as Dr. Hicks mentioned, that aim to reduce or remove the miscalculation from the U.S.-China military relationship. In this administration and as part of

the rebalance, we have already pursued a number of confidence-building measures, military-to-military agreements between the U.S. and China, and we should press forward with continuing to seek more of those, particularly confidence-building measures that may apply to coast guards, because that, of course, is sort of the first line of effort when it comes to China.

We should also seek to reduce miscalculation in other areas where China may feel its own defense interests are threatened by U.S. activities.

So an example is the fact the United States and South Korea are now pressing ahead with THAAD missile defenses following North Korea's most recent nuclear and missile tests. China has long objected to the installation of THAAD on the Korean Peninsula on the grounds that this may threaten their own capabilities, but the United States has recently invited them to inspect and learn more about the THAAD system so that they can have some of their most deep anxieties dissuaded.

We should continue to put forward initiatives like that to try to demonstrate to China where increased capabilities in the region really are not about China and attempt to again reduce miscalculation. Of course, that does not take the sting out of the longer-term military competition that really is between the United States and China, but it should be reduced on the margins where it possibly can be.

VICE CHAIRMAN BARTHOLOMEW: Okay. On that note, I'm going to have to shut down this question and note that we still have one, two, three, four, five people left to ask questions so I think we're either going to have to have our witnesses talk faster or we're not going to be able to answer the questions completely.

But, Dr. Tobin, you're next.

COMMISSIONER TOBIN: Thank you.

I have a question for all of you, but I want to start with Dr. Hicks. You mentioned that your task force saw several areas where we've not had much discussion yet today, such as Korea, in terms of the U.S. rebalance. I'd like to hear what your thoughts are today on the rebalance as it relates to key areas of land such as Korea, Mongolia and the Central Asian countries?

DR. HICKS: There are certainly interests on land. I'm going to answer maybe a little more broadly than that. I think one of the key things in the rebalance strategy that I believe is recognized inside the U.S. government very well, but again not necessarily well articulated, is the importance of diversifying on the security side from a Northeast Asia focus, to include Korea--and I'll talk about Korea in a second--down into Southeast Asia and then over to India, if you will, broadly speaking.

So to ensure that when we talk about and think about the security elements of the rebalance that we are thinking not just in and around East and South China Sea, for example--

COMMISSIONER TOBIN: Right.

DR. HICKS: --or Taiwan, that we are thinking about where is this region going in Southeast Asia? I think there are many opportunities there for building capacities. These are much militarily weaker countries, notwithstanding obviously Australia, and so the type of activities that we should undertake and the type of capacity building and capabilities we should be pushing them toward are different in many cases but very important.

India, incredibly important. The United States and India, I think, are in an opportune time in terms of seeing a combination of interests, seeing common interests, with regard to China for sure, but also with regard to the Middle East, with regard to Afghanistan. There are obviously problems in that relationship given the U.S.-Pakistani relationship and

India's nonaligned status, but that is an area where there is a lot of potential to regrow the rebalance with an incredibly powerful economy and democracy that we should be looking toward for the future.

And then if I can just end on Korea. I'll skip Central Asia for the moment, but if I can just stop on Korea to say obviously the most likely flashpoint for something major involving significant U.S. forces, period, full stop, any kind of forces, and the majority--we have 28.5 roughly U.S. military personnel that are stationed or routinely there. We have many others in Japan, et cetera, that would become involved should something happen on the Peninsula, and we need to keep focused on that.

The THAAD battery decision to place that into South Korea I think is a good example of the fact that in the security community, we're always kind of fighting to make sure we're remembering how important investment for Korea is in terms of maintaining peace and stability in that region.

MR. BLUMENTHAL: Really quickly, on land, South Korea, absolutely, we have to be prepared for a collapse or at least have a strategy for a collapse of North Korea, for the fact that the Chinese may very well want to influence events as well, and obviously our land forces are going to play a very big role in shaping events on the Peninsula.

The other quick thing I would say is when it comes to land in Southeast Asia, we have to remember that these are still very ground forces-based militaries, and they're still very, very focused on internal stability and sovereignty issues. They are new countries. In our engagement with them, in order to get them to a point where they're focusing on maritime issues, we need to, I believe, help them feel that their internal sovereignty issues, their territorial integrity is protected.

COMMISSIONER TOBIN: Thank you.

DR. RAPP-HOOPER: Agree with much of what's been said by my co-panelists. I'll just add that when it comes to the great growth potential in the relationship with India, as part of the rebalance, this is not only bilateral growth potential but the fact that India may act as a force multiplier when it comes to security assistance and other development activities with many of these countries in Southeast Asia.

Most notably, India has an excellent defense relationship with Vietnam so in some countries where the United States has obstacles to making different inroads, India can be a partner, at least a country with whom we should be coordinating when it comes to goals and security assistance.

VICE CHAIRMAN BARTHOLOMEW: Great.

COMMISSIONER TOBIN: So in our next panel, we'll deal with this a little more fully in the One Belt One Road discussion.

Thank you.

VICE CHAIRMAN BARTHOLOMEW: Great. Thank you.

Dr. Brookes.

COMMISSIONER BROOKES: Thank you. Thank you all for your thoughtful testimony.

I have two questions. Dr. Hicks, can you talk a little bit more about China's A2/AD capabilities outpacing U.S.? I mean you mentioned that, if I heard you correctly, and our ability to overcome it.

And for Mr. Blumenthal and Dr. Rapp-Hooper, I like the idea of military cooperation and international cooperation in the South China Sea, but I have to admit I'm

skeptical about the U.S. being able to get the support it needs in the South China Sea from friends and allies due to capability and capacity shortages and perhaps political will due to such issues as possibly U.S. retrenchment in the long term. Can you persuade me otherwise?

Thank you.

DR. HICKS: So I think Mr. Blumenthal laid it out pretty well in the--very well, I should say--in his testimony about the precision strike complex, but just digging into that a little more, the Chinese have invested quite substantially and directly, first with a focus toward Taiwan, and now with that envelope, if you will, moving farther and farther out to sea toward the 9-dash line, et cetera, this capability mix that includes ballistic and cruise missiles, it includes very good jamming capability, electronic warfare capability, and cyber capability relatedly.

They have frighteningly good space capability development in the last several years, in particular. I think the U.S. has become quite alarmed at the speed with which the Chinese have seemed to have aggressively gone after space denial.

COMMISSIONER BROOKES: You mean counterspace, right?

DR. HICKS: Well, I think both. How is that? I was being polite, I suppose, but space denial and counterspace.

And then I think on top of that, you see their growth in areas where we still have a significant advantage so that would be undersea, but they are investing there. I think we still have the best in terms of stealth capability, but again they are developing counters to stealth that make it difficult for us to penetrate that envelope that I talked about that is moving farther and farther away from the China mainland and moving, if you will, therefore, more and more into the space of the allies with whom we have treaty commitments.

So that's the challenge, is the inability, the perception that the United States is reaching a point of inability without significant reevaluation of how we do it to penetrate through areas in that focused region where China seeks in a concerted way to keep the U.S. out.

DR. RAPP-HOOPER: On the capability incapacity issue, I think you're right to be duly skeptical. I don't think either myself or Mr. Blumenthal meant to imply that partner capacity building didn't face substantial obstacles, and it's worth noting off the bat that, for example, the U.S.-Philippines alliance looks nothing like the U.S.-Japan alliance when it comes to the capabilities and capacity for military cooperation in the future.

These are, of course, very long-term projects. The initiatives that are underway at the Pentagon's recent initiative are assumed to take at least five years to start building fruit, and there are a number of reasons why we should be somewhat skeptical, as you note, but there are also opportunities here.

As I mentioned in my testimony, there are at least four other countries that are actively taking an interest in helping Southeast Asian states develop their own maritime capacity. That includes Australia, Japan, India, and South Korea. All four have already taken the initiative and started working with the Philippines, but that raises the question of how the states themselves are going to absorb this type of aid.

So not only does a country like the Philippines need to figure out how it's going to accept all the defense articles it's receiving, but it needs to learn how to maintain that equipment, and it needs to train on that equipment in ways that are mutually complementary and productive with respect to all this aid that it's receiving.

And additionally countries with whom we haven't worked before closely in this area, countries like Vietnam, need to learn how they're going to engage with the Pentagon, with the U.S. government, to figure out what they need and how they're going to get it.

So exactly as you say, there's a lot to be worked out when it comes to U.S. security assistance in Southeast Asia. There is no reason to think it's going to produce radical changes overnight. These countries are largely starting from a land-based perspective, and many of them, including our close treaty ally, the Philippines, have scant naval and coast guard capabilities. So there is a long way to go when it comes to these development efforts, but that doesn't mean it's not worth a decent shot.

MR. BLUMENTHAL: Really quickly, I mean I can give you no confidence in U.S. political will. They say there's no bipartisanship, but we had a bipartisan decision to enact the BCA and sequester and not reverse it, and it's devastating. I mean a lot of the strategies we're talking about here if that's not reversed, we're going to have to have a new strategy in Asia, much more limited and much more minimalist.

And the second point is, look, you know, the U.S. throughout the Cold War has been excellent at security assistance. The FMF program, the FMS program, if you look at where we started with South Korea, with Taiwan, with Japan, you know, they had no militaries essentially, and we can do it. It takes a lot of time. It takes a political context. It takes a common threat perception.

Our FMF, as we've all mentioned, with respect to the Philippines, is minuscule compared to other countries in the world. So with the right sort of strategy, the right allowance and political context and the right ability to decide as a nation that we're going to continue to be in this game, I think over the long-term I do have confidence.

VICE CHAIRMAN BARTHOLOMEW: All right. Senator Goodwin.

COMMISSIONER GOODWIN: Thank you. Thank the witnesses for your time this morning. Dan, it's good to see you again.

I was struck this week in reading the briefing materials that talk about our broad and perhaps overwhelming consensus about the need to remain engaged and committed to our allies in the Asia-Pacific region, and then look up and watch cable news where the very existence of these commitments and alliances are being brought into question or, at a minimum, I think the continuing utility of these alliances has been brought into question.

And without arguing that particular brief, I will note that Secretary Clinton's foreign policy article from five years ago did at least appear to acknowledge the need to reassess these commitments in the region and the need to perhaps repurpose these partnerships for the 21st century, writing we can't afford simply to sustain them; we need to update them for a changing world.

Obviously, I'm interested in your continuing testimony as to how we update these alliances and commitments for new challenges and new opportunities. But I suppose the question that I would pose to the panel, and this moves a little bit beyond your portfolios here today, in doing so, in updating these alliances, do we need to make a corresponding commitment to communicate to the American people the value of American engagement in the Asia-Pacific region? And I suppose the flip side to that question is over the past several decades, have we failed to do that?

DR. HICKS: I do think we've failed to do that. And I think there is, you know, like there are many mothers and fathers to success, there are many mothers and fathers to that failure. I do think that often we have treated--and I'll get to the other question, I promise--I do think we have often treated it is it too much as a domestic versus overseas tradeoff of basing, where there are advantages obviously, particularly for members of Congress, to having basing within the United States.

That has trickled into the military. I myself witnessed many examples where a military service would prefer to maintain a unit inside the United States because they knew they would never lose that force structure. Well, they thought. They were wrong. They thought they would never lose the force structure because there would be a congressional support structure for that, whereas there is no congressional support structure, if you will, for overseas basing and facilities.

So that's a part of the problem. I think also our military, in particular in uniform, they're incredibly powerful advocates. Having them speak more routinely about the importance that they derive from overseas presence is important. I think a small factoid that I like to remind people is that for every aircraft carrier that you put forward in the Pacific, you just saved three more aircraft carriers because it takes four aircraft carriers based in the United States to keep one forward in the Pacific.

If we want to save some money on defense, forward presence and posture ought to be part of that conversation from a straight-up fiscal, selfish, good deal perspective.

In terms of updating the alliances, absolutely. And I think you've seen that happening throughout the region. I mention again Southeast Asia where we know there's a great interest in growing capability for, for instance, humanitarian assistance and disaster relief. Maritime domain awareness, whether it's for those purposes and/or for purposes of counter-narcotics, counter-human trafficking, lots of things, that if you can grow that capability, focus on that area, grow that capability even at the more basic level, it provides benefits for these higher-end capability areas that concern us in the future.

India, again, I think we focused very much. India is recognizing their challenges more globally but certainly with regard to China. I think there are opportunities there to update, and we in the United States and I think India have done an immense amount to push that relationship forward and update. It's not an alliance per se, but that partnership.

And Japan and Korea, we have worked very hard in the United States I think with both partners. Abe has completely I think transformed the Japanese sentiment in terms of security and the willingness of the Japanese to push the bounds of the constitution that we helped them put in place in ways that I think are measured enough that provide good capability without creating the kind of backlash that we would worry about, and again we've been updating the operational changeover with the Koreans for many years, and we should continue to do that.

DR. RAPP-HOOPER: Very briefly, I'll note just when it comes to reassessing and repurposing our alliances, I think for the 21st century, we should be thinking about how best we can transition what has been an incredibly successful hub-and-spoke system in East Asia into something that increasingly looks like a network.

It should be a network because we're adding new partners with whom we haven't always cooperated or collaborated in the past, and it should be a network because many of our most stable and dependable partners, like Japan, are becoming nodes unto themselves and are becoming much more deeply engaged with countries on an individual basis.

Japan, for example, deeply engaged with the Philippines, just recently signed a defense agreement with the Philippines. Japan is a huge part of the way the United States has been able to strengthen its ties with Vietnam. So by not only looking to new partners, but by looking to how very steadfast and dependable partners can strengthen what we're already doing and what we hope to do, I think that network will help to take us forward.

VICE CHAIRMAN BARTHOLOMEW: Thank you.

Dan, very quickly. Okay.

MR. BLUMENTHAL: No.

VICE CHAIRMAN BARTHOLOMEW: Great. Commissioner Cleveland.

COMMISSIONER CLEVELAND: I only have one question. What shall we do about North Korea?

MR. BLUMENTHAL: Well, you know, 20 years later, after the crisis started, we've tried a lot of different things, and the fact of the matter is they still have, they're still acquiring more nuclear weapons and more ballistic missiles and more delivery systems. They're still alive and doing well. The only way to change that is essentially to change China's calculus.

And I would argue that we have had sort of moments, bursts of energy where we've tried, and you can go back to things like the financial sanctions on the Kim regime where the Chinese were very afraid of us chasing that through the entire Chinese banking system and keeping them out of international marketplace. You know that actually worked. We lifted those sanctions in 2006.

The short answer to your question is as long as China sees it as less risky to keep Kim in power than not to, we're going to continue to see this for awhile, and so the only answer to that is changing China's risk calculations such as they see keeping Kim in power as the more risky course. The status quo as the more risky course. And, again, there's various tools we have, not unlimited, for China to see things that way.

VICE CHAIRMAN BARTHOLOMEW: Anybody else want to take on that small question?

[Laughter.]

DR. HICKS: Yeah, I just wasn't sure if you had time available. The key is China. China's view on North Korea is shifting for sure. It doesn't mean it's a completely responsible actor with regard to North Korea, but we certainly saw, for instance, their willingness to support U.N. Security Council resolutions and sanctions of late.

I do think, of course, the credible deterrent in South Korea is very important--and in Japan--is very important to reduce the chances of miscalculation. I wouldn't presume to think that the regime in North Korea is rational enough to know for sure what fully deters, but I think that credibility is important to prevent lashing out, from going too far beyond where we could constrain or would want to constrain the South Koreans, for example, from responding.

And then, as Dan brought up much earlier, I think we have to be very prepared for collapse. It's not something that is a comfortable topic for the Chinese, for instance, to speak to the U.S. about or even the South Koreans to speak to the U.S. about, but the South Koreans and the Chinese will bear the brunt of a collapse scenario, and we need to be ever prodding in these bursts of energy, ever prodding them forward in making sure they are thinking through that.

The last piece I would add is a particular capability set that the United States has that it has to improve on and hone for North Korea, whether collapse or more of an attack scenario, is securing the WMD that is in North Korea, and that will require some focused investments on the part of the United States to recognize that as a particular area for it to secure.

VICE CHAIRMAN BARTHOLOMEW: Dr. Rapp-Hooper, quickly.

DR. RAPP-HOOPER: I'll agree that China is, of course, key to the calculation, and the most recent bill that was signed into law provides for secondary sanctions. The question, of course, is do we want to move forward and how much do we want to move forward with enforcing those because that is a difficult thing for the United States as well as painful for China.

In addition to that, I'll note two other areas. One is the Proliferation Security

Initiative in East Asia could certainly be strengthened. This is an initiative which is largely voluntary. It does not have a lot of internal infrastructure, no coordinating secretariat, no key set of criteria on which interdictions are conducted. So the formalization and institutionalization of the Proliferation Security Initiative would be an important forward step.

And another area I'd point to is deeper cooperation between South Korea and Japan. There is incremental progress in that relationship, a lot of history to get past, but South Korea and Japan absolutely must be sharing information on North Korea's nuclear and missile programs. This will both help to develop their defense relationship but help to improve the way the United States can work with those allies when it comes to North Korean threats.

VICE CHAIRMAN BARTHOLOMEW: Great. Thanks.

One of the upsides of coming last is that I get the benefit of everything everybody said. One of the downsides is that I end up using my time to make comments addressing sometimes things my colleagues have said and things you have said. So I have a few comments before I get into a question.

One, Larry, I just want to go on the record, because I think we need to have the other viewpoint put out there, that the reason that there were IMET cutoffs is because many American taxpayers did not believe that their taxpayer dollars should go to train people who then went on to commit human rights abuses after they had already received IMET training. And Kopassus in Indonesia is one and the School of the Americas is the other.

Dr. Rapp-Hooper, you mentioned that China's challenges to the liberal order are close to home, and I just wanted there--I think it was you who said that--I actually kind of disagree on that point. When you look at other things that they're doing, what I consider a bunch of activities under the long arm of Chinese censorship, they are trying to shut down dissent outside of China, sometimes by arresting family members of people who are Chinese dissidents.

We see other things that are going on, and I would just put another issue out there, which is whether we are going to see the long arm of Chinese censorship affecting what entertainment we even see here in the United States as they own the whole theater chain of AMC, as they're buying production companies in Hollywood. I would love to see somebody in this country try to make a movie about Tibet and see whether that movie will be able to be shown in the theater companies that China owns. That's a very important, I think, emerging issue.

Another issue I just wanted to mention on encirclement, when we were in Vietnam last year, it was really clear that the Vietnamese are very concerned about being encircled by China. So it is not just an issue that the Chinese are facing.

And finally, I think it's really important the point you made, Dr. Rapp-Hooper, that we don't get reciprocated in one area when we make concessions in another, and I think it has been consistently that theme that has undermined the ability or the willingness of American negotiators to strike tough deals in a number of different things.

I would even argue that that goes back to North Korea. When we went through the MFN debates, that we kept saying that can't do anything to upset China in this arena because we need their cooperation on North Korea. Twenty years later, what have we got? So I think that's a very important point that you made.

Back to questions now. Dan, you mentioned some of this, but I guess sort of in closing, in the big picture, what do we think that a successful rebalance would look like? I mean how are things going to look ten years down the road if a rebalance strategy has been successful? I think a lot of people look at the South China Sea and say, you know, we don't really know if

this is working if the Chinese continue to do this.

So what is your picture of what it is that should be accomplished by a successful strategy?

MR. BLUMENTHAL: Okay. I'll take 35 seconds for that. It's great questions and comments. So number one is I think Southeast Asian nations that are functioning with strategic autonomy, that are able to protect well-defined maritime territory and rights without being coerced and able to develop, and I just would come back to this point that these are very new states. I mean we assume sometimes that the Southeast Asian states in ASEAN have been around for a long time. They are newly independent in many cases so just the ability to function and grow economically and develop hopefully on democratic lines, more aligned with us than not, I think would be a success in the next 15 years, and I think we've made some progress towards that end.

And then I think when it comes to the South China Sea, it is a vital U.S. national interest that China not succeed in its claiming the entirety of the South China Sea slowly as territory, and we need to do everything in our power to make that not happen and to keep the South China Sea as a free and peaceful maritime commons.

VICE CHAIRMAN BARTHOLOMEW: Dr. Hicks.

DR. HICKS: Yeah, I think I would just add that I don't disagree with any of that, essentially status quo on the territorial disposition at the moment would be in and of itself a positive; peaceful resolution of all disputes that are going on with regard to such territory; the free flow of goods and services through a vibrant economy there that's linked to the United States; and you know the ability of China to act as a responsible stakeholder in the international community.

VICE CHAIRMAN BARTHOLOMEW: Dr. Rapp-Hooper.

DR. RAPP-HOOPER: I'll agree with all of this. I will just say that these are both tools and ends to themselves, but I think a successful rebalance would produce long and enduring relationships with new partners--notably, Vietnam is a relationship we would like to see really continue to develop in meaningful ways and across dimensions--and would see longstanding traditional partners taking on new roles, both bilaterally in their relations with us and multilaterally. So that includes states like Japan and Australia, and, of course, I would also note the continued safety and security of our allies like the Philippines.

VICE CHAIRMAN BARTHOLOMEW: Thanks.

Now if our witnesses will humor us for just a few more minutes, we'll have Dr. Wortzel with another question.

COMMISSIONER WORTZEL: I wanted to ask Dr. Rapp-Hooper to clarify what we could do to strengthen the language in the Mutual Defense Treaty because I actually think it's pretty tight, and you quote it. You say that if Manila's armed forces, public vessels or aircraft are attacked, the U.S. may invoke the treaty, and that's absolutely correct. And in my opinion, it is that tight language that has prevented the Chinese from doing in Second Thomas Shoal what they did to Vietnam in 1988. Those 11 marines exist on the--or 20 marines, whatever they are--on the Sierra Madre and have not been machine-gunned in the sea like the Chinese did in 1988.

Now, I think there are ways we can make that even tighter. For instance, could we--would it be useful to make a statement that China's maritime militia are controlled by the PLA Navy and Central Military Commission; we, therefore, see their activities as military activities? Would that help tighten it?

But I really think we're kind of caught between a rock and a hard place over the

distinction in the treaty language and our position on the conflicting claims by a bunch of other countries, and I hope you can help clarify that, but I can't.

DR. RAPP-HOOPER: Sure. Let me just say that what I'm suggesting here is not that we revise the treaty language itself but our declaratory policy around the alliance. By and large, we, U.S. officials at the highest levels, have consistently reaffirmed our alliance to the Philippines in public, but we do not in public hold up the language which you just quoted, which is to say that the treaty applies if the Philippines armed forces, troops, vessels come under attack.

This is relevant because it suggests that regardless of the geographic location where those troops or vessels are, the treaty applies, which is to say it would apply in the South China Sea.

The treaty itself, again, I think already has the language that we need here. The point is just to elevate the role of that language in our declaratory policy around the alliance so that there can be no mistaking the fact that it would apply to Philippines troops or vessels that come under attack in the South China Sea.

VICE CHAIRMAN BARTHOLOMEW: Peter, do you have something?

COMMISSIONER BROOKES: I just want to make clear that any of these treaties are subject to political processes within the country. These are not automatic responses so I just want to make that clear in case any of my colleagues are wondering, just even like Article 5 in NATO. So that's an important--that's an important issue that I want to make clear.

VICE CHAIRMAN BARTHOLOMEW: Wonderful. Thank you. You guys have been terrific panelists. I know there are probably some other questions that some of our Commissioners have so we'd love to be able to have the opportunity to continue to work with you. Dr. Hicks, in particular, Senator Talent has a question about a recommendation that you made. So thank you very much.

With the forbearance of our next panel, if they don't mind starting a little bit later than originally scheduled, I'd like to ask people to be back in the room by about ten minutes to 11, and we'll start the next panel a few minutes late.

Thanks very much.

PANEL II INTRODUCTION BY COMMISSIONER JAMES TALENT

HEARING CO-CHAIR TALENT: All right. We'll start the second panel, and I thank our panelists for being here.

We're going to examine the objectives and future direction of the economic side of the rebalance. We'll explore to what extent economic statecraft under the rebalance has reflected American interests and achieved American objectives. We'll assess how this component fits into the United States' broader Asia-Pacific strategy and consider what future economic policies the United States should pursue under the rebalance.

We'll start with Dr. Matthew Goodman. Dr. Goodman holds the William E. Simon Chair in Political Economy at the Center for Strategic and International Studies. He's an expert on current issues in international economic policy with a focus on the Asia-Pacific region.

He has extensive experience working on economic policy issues in the United States government, serving as Director for International Economics on the National Security Council and as Senior Advisor to the Under Secretary for Economic Affairs at the Department of State. He has also worked at the Albright Stonebridge Group, Goldman Sachs, and the Treasury Department.

Next, we'll hear from Dr. Elizabeth Economy, who is the C.V. Starr Senior Fellow and Director for Asia Studies at the Council on Foreign Relations. At the CFR, she has organized an ongoing series of roundtables that assess the U.S. rebalance to Asia strategy.

Dr. Economy is a member of the World Economic Forum's Global Agenda Council on the United States and served as Vice Chair of the WEF's Global Agenda Council on the Future of China.

She has taught undergraduate and graduate level courses at Columbia University, John Hopkins University's Paul H. Nitze School of Advanced International Studies, and the University of Washington's Jackson School of International Studies.

And, finally, we have Dr. Dean Baker. Dr. Baker is the Co-Director and Co-Founder for the Center for Economic and Policy Research. His areas of research include housing and macroeconomics, intellectual property, Social Security, Medicare, and European labor markets.

He previously worked as Senior Economist at the Economic Policy Institute and as an assistant professor at Bucknell University. He's also worked as a consultant for the World Bank, the Joint Economic Committee of the U.S. Congress, and the Organization for Economic Cooperation and Development's Trade Union Advisory Council.

We, again, want to thank the distinguished panelists. As the Vice Chair said in introducing the first panel, we could have gone on for a lot longer on your qualifications. I will remind you to try and keep your remarks to seven minutes so we have plenty of time for questions.

Dr. Goodman, we'll start with you.

**OPENING STATEMENT OF DR. MATTHEW GOODMAN
POLITICAL ECONOMY CHAIR AND SENIOR ADVISER FOR ASIAN ECONOMICS,
CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES**

MR. GOODMAN: Thank you, Mr. Chairman.

I appreciate this opportunity to offer some thoughts on the economic component of the U.S. rebalance to Asia. I have submitted written testimony so I'll only make three points here.

First, nearly five years since it was first articulated, the rebalance still strikes me as a basically sound strategy and one that has been well implemented in many respects.

In preparing for this hearing, I reread Secretary of State Hillary Clinton's "pivot" article from October 2011 and still found it persuasive in terms of its underlying premise, namely, that the United States needs a, quote-unquote, "substantially increased investment" in the Asia-Pacific region, and in terms of the six "key lines of action" it laid out.

Namely, strengthening alliances; deepening working relationships with emerging powers like China; engaging with regional multilateral institutions; expanding trade and investment; forging a broad-based military presence; and advancing democracy and human rights.

In the five years since, the United States has strengthened its alliances in the region and built new partnerships in Southeast Asia; it's joined the East Asia Summit; managed the relationship with China reasonably well, though we can discuss that; and, of course, concluded negotiation of the Trans-Pacific Partnership, or TPP, trade agreement.

As I'll argue in a moment, the economic leg of the rebalance is incomplete, but completion of TPP has to be seen as a major accomplishment, which leads to my second point: ratification of TPP by the U.S. Congress is critical, not only for the success of the rebalance but for American credibility in the Asia-Pacific.

Over five years in the making and completed last fall, TPP promises three substantial benefits for the United States:

The first is economic. TPP is expected to produce significant economic gains for the United States, on the order of half of one percent of GDP in 2030.

Second, TPP will update and uphold the rules of the international trading system at a time when existing rules are out of step with today's supply-chain-based global commerce and under challenge in many respects.

And third, TPP will imbed the United States more deeply in Asia-Pacific affairs, complementing our security presence and reassuring allies and partners of our long-term commitment to the region.

The queue of countries from South Korea to Indonesia eager to join TPP is an indication of the power of the U.S.-led initiative. Even China is taking it seriously, assessing whether it can meet the agreement's high standards.

Against, this backdrop, failure of TPP would be a body blow to U.S. credibility in the region, at a time when our allies and partners there have grown wary of overdependence on China and are yearning for our continued presence and leadership.

Ratification of TPP on the other hand would further entrench the United States as the primary champion of a rules-based order in Asia, as it has been for 70 years.

My third and final point is that while absolutely necessary, TPP is not sufficient to ensure U.S. interests in the Asia-Pacific are advanced. We need a broader economic strategy in

the region, especially to deal with a China that is both stronger and more assertive, on the one hand, yet also still fragile.

In the Xi Jinping era, China clearly has ambitions to restore its historic position at the center of regional affairs. Yet, the country is also undergoing a difficult economic transition, and there are serious questions about the capacity and competence of Beijing to navigate this transition.

Against this backdrop, the next U.S. administration needs to reboot its approach toward Asia, both in substance and mindset. In the economic realm, I suggest in my testimony, in my written testimony, four substantive areas to prioritize:

First, ensuring strong sustainable growth in the United States and investing in the long-term foundations of U.S. strength: infrastructure; education and training; innovation; and so forth.

Second, sustaining U.S. technological primacy by investing in basic research and preventing competitors from undermining our technological edge through cyber-enabled intellectual property theft or other means.

Third, extending the TPP model of standard setting to new countries and new policy areas, such as finance, development, energy, or anywhere we have an interest in spreading high-standard rules.

And fourth, developing a vision and a plan for infrastructure investment in Asia at a time when there is a new "great game" underway among the other powers in the region from China to Japan to Turkey.

I'd be happy to elaborate on these ideas during the discussion. But let me close by saying that a successful economic strategy in the Asia-Pacific requires a new mindset, one that recognizes the opportunities and risks of a slower growing but more assertive China, that starts and ends with confident assertion of U.S. interests, and that includes a greater willingness to impose costs for bad behavior.

U.S. policymakers need to work closely with allies and partners in the region and to engage effectively with the private sector. And Washington needs to do a better job of explaining the importance of Asia and the benefits of engagement to the American people.

CSIS has established a high-level bipartisan commission to help the next administration develop an effective strategy toward Asia that builds on the rebalance but includes these new or upgraded elements. We look forward to sharing the findings of this commission when they are out this summer.

Thank you, again, for inviting me and for your attention.

**PREPARED STATEMENT OF DR. MATTHEW GOODMAN
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**Testimony before the U.S.-China Economic and Security Review Commission
“China and the U.S. Rebalance to Asia”
March 31, 2016**

Matthew P. Goodman
Simon Chair in Political Economy and Senior Adviser for Asian Economics
Center for Strategic & International Studies (CSIS)

Introduction

The ground is shifting in the Asia Pacific. Demographic, technological, and other structural changes are reshaping the region’s economies and politics. In particular, the reemergence of China as a regional power has created enormous new opportunities and risks. All of this has profound implications for U.S. interests; no other region of the world will do more to shape long-term U.S. prosperity and security. Washington needs a robust, comprehensive strategy to seize the opportunities and manage the risks of a changing Asia Pacific. Economics is the lifeblood of regional affairs and must be at the heart of this strategy.

The Obama Administration’s “pivot,” or rebalance, to Asia was an acknowledgment of these realities. After a decade of focus elsewhere, the rebalance was designed to put greater U.S. policy attention on the world’s fastest-growing and most populous region. The Administration has made noteworthy progress in advancing this agenda. Since formally announcing the rebalance in 2011, the United States has joined the East Asia Summit, strengthened existing alliances and built new partnerships in Southeast Asia, and concluded negotiation of the Trans-Pacific Partnership (TPP) trade agreement.

But this is not enough. Against the shifting facts on the ground, Washington needs even more vigorous statecraft in the Asia Pacific, especially in the economic realm. Early ratification of TPP is critical to U.S. credibility in the region and the foundation for broader rule-making efforts there. Greater efforts are needed to preserve and extend areas of U.S. comparative advantage, notably in technology and digital services. In light of growing demand for infrastructure in Asia and the proliferation of initiatives led by other countries, Washington needs a more strategic approach to infrastructure investment in the region. And U.S. government leaders need to do more to explain the importance of the Asia Pacific to the American people.

The good news is that there is strong and growing demand for U.S. leadership in Asia. The queue of countries from South Korea to Indonesia eager to join TPP is one indication of the appeal of U.S.-led initiatives. However, to capitalize on these advantages in a more challenging and competitive environment, Washington needs a new mindset and approach to its economic engagement in the Asia Pacific.

U.S. Economic Engagement in Asia

Since World War II, U.S. policy toward the Asia Pacific has had three core objectives: ensuring peace and stability via a favorable balance of power; advancing prosperity via an open trans-Pacific economic order; and promoting the spread of shared values. The past eight U.S. presidents, from Richard Nixon through Barack Obama, have pursued a broadly consistent strategy to advance these interests. They have shown up, invested in security and economic initiatives that underpin regional peace and stability and advance U.S.-preferred norms, and sought to integrate China more deeply into the rules-based order.

Trade, investment, and other economic policies have been central to U.S. strategy in the Asia Pacific. The traditional U.S. approach to economic engagement has had two distinct features. The first stems from the fact that the United States is a Pacific but not an Asian power. Because of this, Washington has been a vocal and consistent champion of a trans-Pacific, rather than an Asia-only, economic order. This is the logic behind U.S. support for the 21-economy Asia Pacific Economic Cooperation (APEC) forum, which includes five Western Hemisphere countries: the United States, Canada, Mexico, Chile, and Peru. It is no coincidence that these same countries are also all TPP members.

Second, the United States has sought to promote comprehensive trade and investment liberalization and high-standard rules of the road. Since APEC's founding in 1989, Washington has used the forum's non-binding, consensual approach to socialize countries to these objectives and win support for U.S.-preferred rules and norms. More recently, the Korea-U.S. Free Trade Agreement (KORUS) and TPP have been vehicles for Washington to promote broader, deeper, and legally binding liberalization. By comparison, Asia-only integration efforts, such as the Regional Comprehensive Economic Partnership (RCEP), have tended to be shallower and less ambitious.

This engagement has supported impressive growth in U.S. economic ties with Asia. Five of America's top ten trading partners today are Asian countries. Last year, the United States exported more than \$750 billion worth of goods and services to the region, a figure that has roughly doubled over the past decade. Nearly two-thirds of foreign students in the United States hail from Asia, and more than 10 million tourists from the region visited the United States in 2015.¹ These and other exports support more than a million American jobs.² The region is also a vital source of direct investment in the United States, with Asian companies having invested more than \$500 billion as of the end of 2014.³ Estimates suggest that Asian investments in the automobile sector alone directly and indirectly supported more than 1.5 million U.S. jobs last year.⁴

Through the rebalance, the Obama Administration has signaled a renewed commitment to economic engagement and institution building in the Asia Pacific. TPP has been at the core of these efforts. The agreement brings together 12 Asia-Pacific countries representing 40 percent of

¹ <http://www.asiamattersforamerica.org/overview>; <http://www.statista.com/statistics/254156/forecasted-inbound-travel-from-asia-to-the-us/>

² <http://www.asiamattersforamerica.org/overview>

³ <http://www.bea.gov/itable/>

⁴ http://www.jama.org/wp-content/uploads/2015/12/report_final_US_121015.pdf

the global economy. It includes wide-ranging market access commitments and new rules covering intellectual property protection, labor and environment standards, behavior of state-owned enterprises, regulatory procedures, and other behind-the-border impediments to trade and investment.⁵

TPP promises three broad benefits for the United States. The first is economic: by lowering barriers abroad and encouraging more foreign direct investment in the United States, TPP is expected to produce U.S. income gains on the order of half a percent of GDP.⁶ Second, the agreement will update and uphold the rules of the international trading system, at a time when multilateral negotiations are stalled and other countries are challenging established rules. Finally, TPP will embed the United States more deeply in the Asia-Pacific region, complementing the country's security presence there.

Since negotiations concluded in October 2015, a number of Asian economies have expressed interest in joining TPP, including South Korea, Taiwan, the Philippines, Indonesia, and Thailand. This shows the power of U.S. economic leadership in the region. The United States remains the largest economy in the world, and Asians still want unfettered access to our markets, technology, and capital. They may not like U.S. hectoring about norms and standards, but most Asian governments know that market opening and strong rules support their own economic progress. From the perspective of most Asian countries, the problem with U.S. economic engagement in the region is that there is not enough of it.

A Changing Strategic Landscape

Despite these successes, current U.S. strategy is insufficient to meet the shifting trends the region, in particular the rise of China. More than three decades of rapid growth have transformed China from an economic backwater into the second-largest economy in history. This breakneck expansion has raised standards of living for hundreds of millions of Chinese citizens and helped to spur growth across the region. Supported by its membership in the World Trade Organization—a development championed by Washington—China now sits at the center of regional and global value chains. It is the largest trading partner of more than 43 countries, including the United States and virtually every country in Asia, and is one of the world's largest aid donors.⁷

Today, however, the Chinese economy is in the midst of a difficult transition. A slowdown from the double-digit growth of the previous three decades was inevitable, but sustainable growth over the medium term depends on Beijing's ability to manage a transition of the country's economic model from one driven by investment and exports to one led by consumption and services. This in turn requires well-sequenced reforms in the direction of liberalization. Beijing recognizes this challenge and, at the Third Plenum of the Communist Party in November 2013, presented ambitious reform plans to deal with it.

However, over the past year, serious questions have arisen about Beijing's capacity and competence to manage the economic transition. Reforms are widely viewed to have stalled, the

⁵ <https://ustr.gov/tpp/>

⁶ <http://www.worldbank.org/en/publication/global-economic-prospects/GEP-Jan-2016-Implications-Trans-Pacific-Partnership>

⁷ <http://www.businessinsider.com/chart-how-china-has-quickly-become-a-top-trading-partner-2015-9>

authorities have committed several policy errors, and a tightening of political controls has impeded the necessary transition to more innovative growth (as well as created a far less favorable climate for U.S. businesses investing in China). Moreover, massive industrial overcapacity and rising debt have raised concerns about a near-term hard landing in China. At a minimum, the rest of the world will likely need to brace itself for several years ahead of Chinese economic underperformance.

A second, longer-term risk that China's rise poses is strategic. Island building in the South China Sea and grand plans to build infrastructure across Asia are two of the most visible signs that the Chinese leadership under President Xi Jinping is determined to restore the country's historic position at the center of regional affairs. Xi has declared that, "It is for the people of Asia to run the affairs of Asia," a statement clearly at odds with U.S. policies and interests in the region.⁸ This ambition to restructure the regional order is undiminished by China's current economic challenges—and may even be fueled by them, insofar as slower growth undermines the legitimacy of the Communist Party.

These actions are provoking reactions. One beneficial consequence is growing demand for American leadership and engagement in all areas of policy—political, security, and economic. Yet the combination of China's economic slowdown and more assertive foreign policy is arguably making the regional order in Asia its most unstable in decades.

Elements of a New U.S. Economic Strategy

Against this backdrop, Washington needs to rethink its strategy toward the Asia Pacific. The first step is to acknowledge that the United States is no longer the sole or even dominant power in the region; we will increasingly be required to live with a more capable challenger willing to assert its newfound economic might in ways that are often at odds with U.S. interests. As the success of the TPP negotiations illustrates, Washington can still set the agenda in Asia, but it will need to be smarter and avoid committing unforced errors, as the Obama Administration did in its handling of China's proposal to create an Asian Infrastructure Investment Bank (AIIB).⁹

In substance, the first priority is to ratify TPP, ideally before the end of this administration. Failure of TPP would be a body blow to U.S. credibility in the Asia Pacific; as a senior U.S. official in Asia said to this author recently, "It would have been better never to have started out on this road." Even an extended delay in ratification—likely if the process slips into a new administration—would give the initiative to China as it asserts its leadership in the region. By contrast, ratification would be a powerful statement of U.S. commitment to the region at a time when Asians have grown wary of overdependence on China.

Even if it succeeds in winning passage of TPP, the Obama Administration is likely to have little time or capital left for bold new departures on Asia policy before it leaves office in January 2017. It will be up to the next administration to reboot U.S. economic strategy toward Asia. Building on the successful elements of the rebalance, the new administration should design a strategy that includes a number of priority elements.

⁸ http://www.china.org.cn/world/2014-05/28/content_32511846_2.htm

⁹ http://csis.org/files/publication/150424_global_economics.pdf

First, successful international economic policy begins with a strong economy at home. The medium-term outlook for U.S. growth is uncertain, and renewed stimulus policies may be needed early in the next Congress and administration. In addition, Washington should do more to invest in the foundations of U.S. economic strength—especially infrastructure, education and training, and innovation. Tax, social security, and regulatory reforms are also important to long-term economic success.

Second, a new strategy should put a priority on sustaining U.S. technological primacy. The United States is a global technology leader, with attendant benefits for national security and economic growth. To maintain this position, Washington needs to ensure that we are both running faster than others—e.g., by investing in basic research—and preventing competitors from undermining our technological edge—through cyber-enabled intellectual property theft, mandatory technology transfer requirements, or forced data localization. In addition, Washington should review its current export-control and investment-review procedures to ensure that sensitive technology is not leaking to potential adversaries.

Extending the TPP model of rule making and standard setting to other countries and policy areas would be another valuable element of a new economic strategy toward Asia. As mentioned earlier, there is a queue of countries waiting to join TPP; following ratification, priority should be placed on accession by South Korea and other countries willing to live up to TPP's high standards—ultimately including China if it prove its readiness. Moreover, the gravitational pull of TPP suggests that it could be a model for other economic initiatives outside trade and investment. Wherever the United States has an interest in spreading high-standard rules—whether in finance, development, or energy—the lessons learned from the successful TPP approach of starting small with like-minded countries and incentivizing others to join could be instructive.

Finally, a new strategy should include a U.S. vision and plan for infrastructure investment in Asia. There is a new great game underway in Asia, as seen in China's One Belt, One Road strategy, Japan's quality infrastructure initiative, and similar plans by other powers in the region. At stake is the physical structure and geographic orientation of the regional economic order. In particular, an infrastructure network where all roads, railways, and data highways lead to Beijing will entrench Chinese centrality in regional value chains and reinforce a Sinocentric economic geography. The United States is not an infrastructure superpower, but it does bring formidable assets—great companies, plentiful capital, rule of law, and high standards—to this new competitive playing field in Asia.

A New Mindset

An effective Asia strategy is not just a matter of updating Washington's substantive policy toolkit. It also requires a new mindset, one that starts and ends with confident assertion of U.S. interests. Washington must understand the key role economics plays in regional political and security affairs. There must be a willingness not only to incentivize countries to follow the U.S. lead but also to impose costs on bad behavior. A successful strategy requires Washington to work with allies and partners in the region, and to engage effectively with the private sector—the sharp edge of the spear of our engagement in Asia. And the administration must develop messages and modes of engagement that resonate with key constituencies in Asia and at home, including local governments and civil society.

This is a tall order for any administration, given the inevitable press of other business both at home and abroad. Asia is not burning—but it is transforming in profound ways that may not always favor U.S. interests. A well-conceived and energetically executed strategy toward the world's most dynamic region is not only worth the investment of time, resources, and political capital; it is essential to long-term U.S. prosperity and security.

To help the next administration develop an effective economic strategy toward Asia, CSIS has established a high-level, bipartisan commission consisting of 18 senior former officials, business people, and scholars with deep experience on Asia and/or international economic policy. Co-chaired by former U.S. Trade Representative Charlene Barshefsky, former Utah Governor and U.S. Ambassador to China Jon Huntsman, and Chubb CEO Evan Greenberg, the CSIS Asia Economic Strategy Commission (AESC)¹⁰ plans to issue its analysis and recommendations this summer. We look forward to briefing the Commission on our findings.

¹⁰ <http://aesc.csis.org>

**OPENING STATEMENT OF DR. ELIZABETH ECONOMY
SENIOR FELLOW AND DIRECTOR FOR ASIA STUDIES, COUNCIL ON FOREIGN
RELATIONS**

DR. ECONOMY: Thank you very much, Senator Talent, Vice Chair Bartholomew, and distinguished members of the Commission. It is a pleasure to be here speaking before you on the economic aspects of the rebalance to Asia.

I'd like to begin by just saying a few words about the nature of the rebalance writ large, then focus in on how China has responded to the economic aspects of the rebalance, and finally conclude with some thoughts about U.S. policy moving forward in light of the Chinese reaction.

The rebalance has emerged as one of the most consequential strategic initiatives of President Obama's tenure. U.S. interests in the Asia-Pacific are clear and compelling. The region's economies represent more than half of world economic output and roughly half of all maritime trade passes through the South China Sea.

It is a region that boasts some of the world's most robust as well as many of its nascent and still potential democracies, and although it has experienced decades of relative peace and stability, it is a region that faces significant challenges from terrorism, narcotics trafficking and, increasingly, conflict in the maritime domain.

While we often think about the rebalance as comprising three separate strands of U.S. policy--economic, political and security--the reality is that they are three sides of a mutually reinforcing triangle. Without security, trade and investment, as well, democracy cannot thrive. Without a strong economy, good governance and security are far more difficult to attain, and good governance provides the foundation for both long-term economic growth and a stable security environment.

Finally, as the rebalance or pivot enters its fifth year, we should consider it an ongoing and dynamic process. The U.S. should be continually evaluating and adjusting its efforts, depending on its changing interests and those of the region.

So with those points in mind, let me turn now to the economic element of rebalance and China's response. The main thrust of the economic balance has been the Trans-Pacific Partnership, as Matt just mentioned. While there are additional economic initiatives, such as the New Silk Road, the heart of the rebalance is really the TPP. China is not party to the agreement, and according to most trade economists will not be able to meet the standards of the agreement for many years.

Nonetheless, given the scale and scope of the agreement, the TPP has generated a strong reaction from Beijing. It has elicited a lively debate among senior policy analysts and officials, and it has contributed to a wave of economic initiatives designed to enable Beijing to shape the region's economic future.

Let me spend a minute or two talking about each of these. China's debate over the TPP is ongoing and evolving. There are those who believe that the TPP is designed to contain China. As one Chinese analyst put it, "It is an example of American aggression against China." This view, while not as popular as it was two or three years ago, is still voiced in some circles. Other analysts and officials, however, such as Deputy Finance Minister Zhu Guangyao have argued that a high-end trade agreement, such as the TPP, offers an opportunity for China to become more integrated into the global system with high standards.

A number of prominent economists also believe that TPP can help advance

challenging economic reforms at home. There are worries over the loss of export opportunities. By one estimate, TPP will cost China 1.2 percent of exports by 2025.

And at the same time, some officials are concerned about China's ability to meet IP and labor standards. Interestingly, when the agreement was formally signed, what I heard most from officials and Chinese business people was unhappiness that Vietnam was party to the agreement. There was strong sentiment that if Vietnam were allowed in, China should be as well.

I would say overall, at this point, China is watching to see whether the TPP is ratified, is interested in keeping the door open to Chinese participation, but more importantly is developing its own economic strategy for the region.

To that strategy, certainly as the United States has been working hard to bring the TPP to fruition, China has not been standing still. It is focused on developing a trade and investment architecture that will counteract the TPP and cement the centrality of China in the region. I would characterize the strategy as "all roads lead to Beijing."

Beijing is pushing forward on regional trade agreements, such as the Regional Comprehensive Economic Partnership and the potential future Free Trade Area of the Asia-Pacific, and has served as the driving force behind the establishment of two large development banks: the Asian Infrastructure Investment Bank and the New Development Bank.

The centerpiece of Beijing's strategy, however, is One Belt One Road, which is a grand-scale initiative to connect 64 nations across four continents and accounts for 70 percent of the global population and 55 percent of GDP. While it was originally conceived of largely as an infrastructure initiative, it has expanded to include connectivity through telecommunications, finance, investment agreements, as well as culture and soft power.

China will provide \$40 billion toward a Silk Road fund to enable the One Belt One Road to get off the ground. One leading scholar, Zhang Yunling, has called the One Belt One Road China's "pivot to the west," and PLA General Qiao Liang has referred to it as a hedging strategy against the U.S. pivot.

In this way, One Belt One Road speaks to Xi Jinping's larger political theme of the rejuvenation of the great Chinese nation and also serves as a response to the rebalance.

There are several implications for U.S. policy moving forward with the rebalance. First, I think there are opportunities for both leverage and cooperation to be found in China's ambition for economic leadership in the region and beyond.

As China is preparing to host the G20 this year, for example, it has established green finance as one of its central platforms. This offers an opportunity to bring Chinese lending standards more in line with those of the United States or EU and to ensure that China doesn't use One Belt One Road, or its banks, to export its overcapacity in energy-intensive and polluting industries.

Along these same lines, the U.S. should work with China and other countries to ensure that AIIB and NDB operate with standards comparable to those of the other global development banks. Statements emanating from Chinese economic officials have been less than clear concerning standards and best practices.

Realizing a bilateral investment treaty and initiating discussions on participation in TPP are also important means for the United States to help ensure that as China's economy continues to develop, it does so in ways that offer U.S. firms opportunities to compete freely and fairly.

Second, echoing Matt again, the U.S. needs an economic strategy for the region

beyond a TPP. AIIB and OBOR both have the potential to reconfigure the landscape of Asian development in ways that disadvantage U.S. companies although that is certainly not explicit in their mandate. Nonetheless, the U.S. will need to enhance its commercial diplomacy to remain competitive.

One possibility would be to develop a list of targeted sectors where U.S. strengths most closely match up with the region's needs, such as clean energy, telecommunications, agriculture and entrepreneurship, and develop more coordinated or integrated development proposals involving Commerce, Ex-IM Bank, and U.S. companies. This economic strategy could also engage American NGOs.

I'll skip a bigger discussion of that just to finish up with a final point, that I think it's time for the administration to rewrite its economic narrative in the region. The story over the past decade or more has been that the United States provides the security for the Asia-Pacific while China provides the economic benefits. However, among the top five sources of foreign direct investment in ASEAN in 2014, the U.S. was fourth, just slightly below Japan, well under the EU and ASEAN, but China was a distant fifth.

And while China is the largest trading partner for virtually every country in North and Southeast Asia, many countries, such as Vietnam, Cambodia, and the Philippines, run significant trade deficits with China and surpluses with the United States. Vietnam, in fact, exported almost twice as much to the United States as it did to China in 2013. So the story of the U.S. as a leading investor in the region and market for the region's exports is one that should be told more forcefully.

Finally, let me just concur with Matt that the U.S. needs to ratify TPP. Estimates as to the costs and benefits vary greatly. Fundamentally, however, the TPP represents not only our own significant economic effort in the region but also is at the heart of our credibility as a regional leader.

Thank you.

**PREPARED STATEMENT OF DR. ELIZABETH ECONOMY
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**Testimony before the U.S.-China Economic and Security Review Commission
Objectives and Future Direction for Rebalance Economic Policies**

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March 31, 2016**

The Rebalance to Asia

President Obama's 2011 pivot or rebalance to Asia reflects two complementary strategic imperatives: first, an acknowledgement and reassertion of enduring U.S. security, economic, and political interests in the region; and second, a response to the call by America's allies and partners in the Asia Pacific for a more deeply engaged United States as a hedge against a rising, and potentially destabilizing, China.

While much of the world's attention on the rebalance has been on the security commitment, the importance of the economic component cannot be overstated. The Asia Pacific is a center of global economic growth and a critically important trade and investment partner for the United States. In 2014, Asia Pacific Economic Cooperation (APEC) countries accounted for 58 percent of global GDP, and during 2000–2014, the value of Asia's import market jumped by 261 percent from \$1.5 trillion to \$5.4 trillion.¹ The Association of Southeast Asian Nations (ASEAN) represents the fourth largest export market for American goods and services, and it supports nearly 500,000 American jobs.² China's significance as an export market for American companies also continues to grow: from 2005 to 2014, U.S. exports to China increased by 198 percent, making the country America's third largest export market.³

The Asia Pacific is also an important source of investment for the United States and investment destination for American companies. Japan was the second largest source of foreign direct investment in the United States (after the Netherlands) in 2014 and is the second largest cumulatively (after the United Kingdom). Japanese investment, particularly in the automobile sector, accounts for as many as 400,000 U.S. jobs.⁴ Chinese investment in the United States, which has been rising over the past several years, supports about 80,000 jobs.⁵ Cumulatively, the United States is the largest investor in Southeast Asia, but on an annual basis, over the past three

¹ Jay Chittooran, "Losing Ground in Asia: Why the U.S. Export Market Share has Plummeted," *The Third Way*, August 5, 2015, www.thirdway.org/report/losing-ground-in-asia-why-the-us-export-market-share-has-plummeted.

² Charles H. Rivkin, "Advancing U.S. Economic Engagement in Asia," testimony before the House Foreign Affairs Committee, May 14, 2015, <http://www.state.gov/e/eb/rls/rm/2015/242411.htm>.

³ The US-China Business Council, "US State Exports to China (2005-2014): Executive Summary," 2015, <https://www.uschina.org/reports/us-exports/national>.

⁴ Theodore H. Moran and Lindsay Oldenski, "Japanese Investment in the United States: Superior Performance, Increasing Integration," Peterson Institute for International Economics, February 2015, <http://www.iie.com/publications/pb/pb15-3.pdf>.

⁵ Jamil Anderlini, "Surge in US workers employed by Chinese companies," *Financial Times*, May 22, 2015, <http://www.ft.com/intl/cms/s/0/0da0c392-0042-11e5-a908-00144feabdc0.html#axzz42ysBhKgh>.

years, it has been superseded by the European Union, Japan, and China. The value of U.S. trade and investment ties with Asia Pacific countries is likely only to grow. According to one estimate, by 2030, over two-thirds of the world's entire middle class will be in Asia,⁶ providing a significant new market for U.S. consumer and other goods.

The Obama administration's rebalance has acknowledged the importance of the economic relationship in several different ways. Most significantly, it contributed to the successful completion in November 2015 of the Trans-Pacific Partnership (TPP) agreement. The free trade accord involves twelve countries (the United States, Japan, Australia, Malaysia, Vietnam, Singapore, New Zealand, Brunei, Mexico, Canada, Peru, and Chile) and represents roughly 40 percent of global GDP and 25 percent of world exports. It is notable for the high standards it sets for labor rights, the environment, and intellectual property rights protection, among other issues. A study by the Peterson Institute predicts the United States will gain \$78 billion in annual exports from the TPP, while opportunities for outward investment will increase by \$169 billion and inward investment by \$47 billion. Other countries will also benefit: Vietnam and Japan will be biggest winners; China will be a significant loser as long as it remains outside the deal.⁷

The administration has also rolled out a number of additional economic and trade initiatives in the region, such as the U.S.-ASEAN Expanded Economic Engagement initiative, a U.S.-Pakistan Economic Partnership Week, and the New Silk Road.

Progress, albeit very slow, continues to be made in advancing a bilateral investment treaty (BIT) with China. As China continues the process of economic reform and continues to seek positions of economic leadership globally, a BIT will be a critical mechanism for ensuring fair and open access for U.S. companies to the Chinese market.

In addition, with the rebalance, U.S. government agencies have stepped up to the plate to support American business interests in Asia. The Export-Import Bank (Ex-Im Bank) has supported a number of significant deals in Asia, including the export of fleets of Boeing aircraft to Korean Airlines and Indonesia's Lion Air.⁸ In November 2012, the Ex-Im Bank announced \$5 billion in export financing, particularly targeted toward clean energy under President Obama's U.S.-Asia Pacific Partnership for a Sustainable Energy Future. This will buttress other collaborations the bank has undertaken to support gas-fired and solar power in India.⁹ The bank also is helping finance sixty-two General Electric wind turbines in Vietnam.

The rebalance has also evinced an activist commercial diplomacy. Secretary of Commerce Penny Pritzker has ratcheted up the level of American commercial diplomacy in Asia, traveling at least seven times to the region during 2013–2015, including a trip to Vietnam, Myanmar, and the Philippines, with CEOs and the U.S.-ASEAN Business Council. Under her watch, the

⁶ Jay Chittooran, "Losing Ground in Asia: Why the U.S. Export Market Share has Plummeted," *The Third Way*, August 5, 2015, www.thirdway.org/report/losing-ground-in-asia-why-the-us-export-market-share-has-plummeted.

⁷ Peter A. Petrie and Michael G. Plummer, "The Trans-Pacific Partnership and Asia-Pacific Integration: Policy Implications," Peterson Institute for International Economics, June 2012, <http://www.iie.com/publications/pb/pb12-16.pdf>.

⁸ Export-Import Bank of the United States, "Ex-Im Bank Approves \$1.1 Billion in Financing for U.S.-Manufactured B737-900ER Aircraft to Indonesia's Lion Air," March 5, 2013, <http://www.exim.gov/news/ex-im-bank-approves-11-billion-financing-for-us-manufactured-b737-900er-aircraft-indonesias>.

⁹ Fred P. Hochberg, "ASEAN Ambassadors' Breakfast on East Asia Energy Partnership: Welcoming Remarks," January 16, 2013, <http://www.exim.gov/news/archives/speeches/asean-ambassadors-breakfast-east-asia-energy-partnership>.

administration has also added Foreign Commercial Service offices in Wuhan, China, and Yangon, Myanmar.¹⁰ Secretary Pritzker has also focused particular attention on clean energy, leading commercial delegations to Japan and South Korea on healthcare and energy, as well as to China on green infrastructure and energy efficient industries.¹¹

While most countries in the Asia Pacific welcome an increased level of U.S. economic engagement through new trade and other arrangements, China has a more ambivalent stance. It has its own economic ambitions in the region, which it is pursuing aggressively, and a renewed emphasis on U.S. economic engagement is not always welcomed. In addition, as long as China remains outside the TPP, assuming it comes to fruition, the agreement is likely to exert a profoundly negative impact on the Chinese economy. Nonetheless, there are some areas of overlapping interest between the United States and China that can be pursued for common gain.

The Chinese Perspective

China's energies in the Asia Pacific have been devoted to advancing its own economic centrality in the region. Chinese President Xi Jinping has pressed forward with a trade, investment, and security architecture that, if fully implemented, will reshape the political and economic landscape of the Asia Pacific. Beijing has successfully established the Asian Infrastructure Investment Bank (AIIB), with participation from almost sixty countries. The AIIB expects to lend \$10–15 billion annually for the first several years, and the bank's leadership has stated that it will maintain high standards for transparency as well as social and environmental safeguards, although it will not enforce IMF lending standards.¹² According to one Chinese analyst, Chinese officials see the AIIB as helping with overcapacity, increasing demand for Chinese commodities, spurring RMB internationalization, and helping China increase its influence in setting world economic and financial rules.¹³

Beijing's regional economic platform also includes the sixteen-member Regional Comprehensive Economic Partnership, which is scheduled to be completed by the end of 2016 and is estimated to help trade between China and the rest of the region reach \$1 trillion by 2020.¹⁴ Further into the future, President Xi has also proposed a Free Trade Area of the Asia Pacific, which the Peterson Institute estimates would benefit China more than any other country.

China's most significant initiative, however, is its grand-scale One Belt, One Road initiative, which in part recreates China's traditional Silk Road, providing land and maritime connectivity from China through Asia, the Middle East, Africa, and Europe. If realized, the One Belt, One

¹⁰ United States Department of Commerce, "U.S. Secretary of Commerce Penny Pritzker Leads CEO Mission to Show U.S. Commitment to Asia," May 30, 2014, <https://www.commerce.gov/news/blog/2014/05/us-secretary-commerce-penny-pritzker-leads-ceo-mission-show-us-commitment-asia>.

¹¹ Penny Pritzker, "U.S. Secretary of Commerce Penny Pritzker Addresses the American Chamber of Commerce in South Korea," Department of Commerce, October 23, 2014, <https://www.commerce.gov/news/secretary-speeches/2014/10/us-secretary-commerce-penny-pritzker-addresses-american-chamber-0>.

¹² Sue-Lin Wong, "China launches new AIIB development bank as power balance shifts," Reuters, January 17, 2016, <http://www.reuters.com/article/us-asia-aiib-investment-idUSKCN0UU03Y>.

¹³ Zhang Maorong, "Significance of Establishing the AIIB," *China-US Focus*, February 19, 2016, <http://www.chinausfocus.com/finance-economy/significance-of-establishing-the-aiib/>.

¹⁴ "ASEAN-China trade expected to reach 500 bln USD by 2015," Xinhuanet (November 14, 2014) http://news.xinhuanet.com/english/china/2014-11/14/c_133788265.htm

Road will connect sixty nations across four continents. Beijing has pledged \$40 billion to support the development of transportation and trade networks, with additional funding planned from the AIIB. Originally conceived as a trade and investment opportunity, the project has now expanded to include financial arrangements, people-to-people exchanges, and a call to advance Chinese soft power. As *Global Times* journalist Ding Gang has commented, “China’s new leadership has proposed building a community of common destiny with its neighboring countries. Such a community cannot be simply established through a connection of rails, highways, and airplanes. Spiritual commitment is equally important... the exchange and compromise of interests cannot make a country’s diplomacy resonate; its charisma can only be amplified through ethical strength.”¹⁵

While these initiatives are primarily designed to advance Chinese economic interests, Chinese analysts also understand them in the context of countering the rebalance. Renmin University Professor Wang Yiwei, for example, has noted, “The New Silk Road Initiative [another term for One Belt, One Road] could help redirect the centre of geopolitical gravity away from the US and back to Eurasia.”¹⁶

With particular regard to the pivot or rebalance, Chinese analysts and officials express a range of views. Initially, most believed that the TPP was an effort to contain China by excluding it from the most significant multilateral trade agreement in the region. America analyst Zhang Zhixin, for example, referred to the TPP as “another example of American aggression against China.”¹⁷ Some Chinese scholars also expressed fears about the real costs to China associated with the agreement. One Chinese scholar, citing the Peterson report, pointed out that by 2025, the TPP is estimated to cause a drop in China’s GDP of .3 percent by 2020 and cost China 1.2 percent of exports due to trade diversion by 2025.¹⁸ Others, particularly in the Ministry of Finance and the Ministry of Foreign Affairs, however, have argued that the TPP offers opportunity. Vice Finance Minister Zhu Guangyao has stated, “As China becomes more open, it’s very important for us to be integrated into the global trade system with a high standard.”¹⁹ Many Chinese economists believe that the TPP will be a useful prod to China’s own domestic economic reform effort.

While the official position is to remain open to participation in the TPP, there are also concerns that the demands for intellectual property protection and state-owned enterprise (SOE) reform are “excessively high” and that it will be challenging to achieve “competition neutrality” in which Beijing would not grant privileges to its SOEs.²⁰ In private conversations, a number of Chinese businesspeople and analysts have also complained that if Vietnam is included, China should be as well.

¹⁵ Ding Gang, “Unconditional aid shows true strength,” *Global Times*, November 13, 2013, <http://www.globaltimes.cn/content/824725.shtml>.

¹⁶ Wang Yiwei, “One Belt One Road: Opportunities for Europe-China cooperation,” *Europe’s World*, May 13, 2015, <http://europesworld.org/2015/05/13/one-belt-one-road-opportunities-europe-china-cooperation/#.VuwwqOIrk70>.

¹⁷ Zhang Zhixin, “Why China Has Good Reason to Worry About the US Rebalance Strategy?” *China-US Focus*, July 8, 2014, <http://www.chinausfocus.com/foreign-policy/why-china-has-good-reason-to-worry-about-the-us-rebalance-strategy/>.

¹⁸ Zhang Xiaotong, “China’s Views of the TPP: Take it or Leave It, That is the Question,” Wuhan University Center for Economic Diplomacy, November 21, 2014, <http://www.whuced.com/show/?id=110&siteid=3>.

¹⁹ Keith Bradsher, “Once Concerned, China is Quiet About Trans-Pacific Trade Deal,” *The New York Times*, April 28, 2015, <http://www.nytimes.com/2015/04/29/business/international/once-concerned-china-is-quiet-about-trans-pacific-trade-deal.html>.

²⁰ Zhang Xiaotong, *op. cit.*

Ensuring Balance in the Rebalance

The rebalance is often understood as three distinct strands of policy—maintenance of open and secure sea lanes; adherence to free market–based trade and investment; and promotion of good governance, including protection of intellectual property, the rule of law, transparency, and free-flowing information. It is better understood, however, as a type of strategic triangle, with each side providing critical reinforcement to the other two. A stable security environment enables economic growth and human rights to prosper. Good governance is necessary to ensure long-term stability and economic development. And economic development is an essential underpinning of long-term military and political stability.

Enhancing America’s economic engagement, therefore, requires not only fulfilling pledges on the economic front, but also in the security and political realms. There are several steps the United States should take to ensure that its economic interests in the region are realized:

- Above all, the U.S. Congress should ratify the TPP. It is the economic heart of the rebalance and its realization is critical to the credibility of the United States in the region.
- If not underway already, the USTR should initiate dialogues with other nations interested in joining the TPP, such as the Philippines, Taiwan, South Korea, and China.
- The next administration should make the realization of a BIT with China a top priority. As the European Union moves forward with its own China BIT negotiations, the United States should coordinate its positions to the extent possible. The BIT provides the United States with the best opportunity to achieve a level playing field with China through greater access to the Chinese market for U.S. financial services, national treatment for U.S. investors, reduced caps on foreign ownership, increased transparency, relaxed controls on repatriated profits, enhanced cross-border data flows, and the elimination of policies such as enforced technology transfer and forced localization of production.²¹
- The United States should develop a strategic plan for how it wants to participate in the next stage of Asia’s economic development. It could, for example, target three or four particular areas of infrastructure development, such as transportation, clean energy, agriculture, and telecommunications, and focus the energy of U.S. agencies around those issues. Without such strategic guidance, U.S. trade and investment efforts will suffer in Asia’s highly competitive economic environment, particularly in the face of China’s, and even Japan’s, strategic economic planning.
- Congress should ensure continued and unwavering support for the Ex-Im Bank. The political gamesmanship surrounding the Bank is detrimental to the interests of thousands of U.S. companies. In order for U.S. firms to be competitive with those of other countries, particularly those from countries such as China that receive strong state support for their commercial activities abroad, export finance is essential.

²¹ Dan O’Flaherty, “The U.S.-China BIT Debate,” *Investment Policy Central*, 2012, <http://www.investmentpolicycentral.com/content/us-china-bit-debate>.

- The White House should more closely integrate U.S. commercial diplomacy with the region's strategic economic plans. The Asia Pacific has significant infrastructure needs in agriculture, information and telecommunications, and energy. Targeted delegations as part of presidential summits in these particular arenas would be particularly beneficial for boosting the visibility and impact of U.S. firms.²²
- The Obama administration should breathe life into dormant initiatives. The U.S. New Silk Road, which engages Central and South Asia, was announced in 2011 with four main areas of focus: regional energy markets, trade and transport, customs and border operations, and business. To date, the United States has invested roughly \$1.7 billion in developing energy and transportation infrastructure, primarily in Afghanistan. Additional projects are progressing slowly. If greater support is not provided, the initiative will cost the United States its credibility, particularly in light of the far more robust Chinese One Belt, One Road initiative, and the deep engagement of both China and Russia in the region. Opportunities to cooperate and partner in the region with others such as Japan or the European Union should also be explored.
- Congress should increase funding for NGO work throughout the Asia Pacific that contributes to strengthen good economic governance. The United States devotes roughly 4 percent of its global aid spending to Asia, a very small amount given the population of region.²³ Support for organizations such as the Asia Foundation,²⁴ the National Endowment for Democracy, and the International Republican Institute should be increased. These organizations help nascent and emerging democracies establish the foundations of governance for open and well-functioning markets. The Asia Foundation, for example, supports a program in the Philippines to improve the effectiveness of the judicial system, has worked with Mongolia to improve transparency and accountability in the country's anti-corruption effort, and has supported legal education for Indonesia's top law schools.

The rebalance, at its heart, is about rules of the road in the Asia Pacific and what those rules should look like for the better part of the twenty-first century. Now that the Obama administration has reaffirmed its vision for what those rules should be, it will be up to the next administration to ensure that they are advanced and implemented.

²² Lucio Blanco Pitlo III, "US-ASEAN Summit: Is the US Catching up with China," *China-US Focus*, March 9, 2016, <http://www.chinausfocus.com/foreign-policy/us-asean-summit-is-the-us-catching-up-with-china/>.

²³ Joshua Kurlantzick, "The Pivot in Southeast Asia: Balancing Interests and Values," *Council on Foreign Relations*, January 2015, <http://www.cfr.org/asia-and-pacific/pivot-southeast-asia-balancing-interests-values/p35925>.

²⁴ I have served a board member of the Asia Foundation since 2014.

**OPENING STATEMENT OF DR. DEAN BAKER
CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH**

DR. BAKER: Thank you, Senator Talent. I appreciate the opportunity to address the committee on these issues.

I want to make two main points in my comments here this morning. First off, I want to argue that the dollar is still overvalued against the Chinese currency, that although there's been considerable progress in moving them more into balance, that in spite of what's often said in the media on this, that China is still managing its currency in a way that on average lowers its value against the dollar.

The other point is simply to make explicit something that should be evident, that we don't have a single economic interest vis-a-vis China, that there's serious conflicts among different interest groups in the United States, which I just think is important as we talk about our relations vis-a-vis China, that there are clearly groups that will be favored at the expense of other groups.

Okay. The first point, and this is the one that I think is really crucial and what I'd like to emphasize, is that we continue to suffer from having a very large trade deficit with China. It was almost \$370 billion last year, and that has enormous consequences for the economy. Conventional economists think that a trade deficit doesn't matter with the idea that we could easily make up that demand from other sources. Whether or not that's been true historically, it certainly has not been true since the years of the financial crisis.

In other words, I think it's a fairly widely held view among economists that the economy has been seriously below full employment ever since the recession began in 2007. And what that means is that the demand loss due to the trade deficit, whether it's with China or any other country, is not being made up. So for that reason, the trade deficit is of very large importance.

Now, if we turn from the trade deficit, the explanation that I and others would give is that China has deliberately held down the value of its currency against the dollar. The basic story is a fairly simple one. You expect a country, other things equal, that's running a large trade surplus with another country, to have its currency rise in value relative to the currency of the other country.

As we know, that did not happen with China or it did not happen as rapidly as we might have expected because China quite deliberately adopted a policy of keeping its currency down against the dollar and buying up huge amounts of reserves.

Now what's been widely noted, has been that that process has been reversed. Within the last year or so, China instead of buying reserves has actually at several points sold large amounts of reserves in order to keep its currency from falling. This is taken as meaning that it's no longer keeping down the value of its currency, that it's actually doing the opposite.

I want to challenge that view, and the argument I would make here is that stocks matter, the point being that China still holds well over \$3 trillion in reserves. And this is an extraordinary amount of reserves really for any country to hold but particularly for China given that it has very diversified mix of exports and very diversified mix of export partners. So the idea that China would face an extraordinary threat due to a sudden cutoff of export markets really is not plausible.

And again I know there have been arguments that the IMF recently put out a paper that justifies these large holdings of reserves. I'll simply point out that there's no other

country or no other major country that has held a comparable amount of reserves relative to GDP, or relative to its imports, as China. So this really is an extraordinary amount of reserves for it to be holding.

Now in terms of its influence on the exchange rate, what I would just refer to here is that the Fed's quantitative easing policy, currently the Fed is no longer buying assets. This was, of course, the policy of buying long-term bonds and mortgage-backed securities with the idea of bringing down long-term interest rates. That policy was ended over two years ago. Yet, the Fed as a result of that policy currently holds well over \$3 trillion in assets.

Now I suspect you'd find a fairly wide consensus among economists that the net effect of the Fed's policy at the moment is to keep down U.S. interest rates even though their most recent move back in December was actually to raise the short-term interest rate, the point being by virtue of holding this massive amount of assets, it's raising their price relative to a situation where it had more normal holding, say somewhere in the order of 500 or 600 billion.

I'd say the exact same logic applies in the currency markets internationally by virtue of the fact that China is holding an extraordinary amount of reserves, it's keeping its currency down relative to the dollar, relative to other currencies, and in that way, it's allowing a trade surplus with the United States and other countries to continue.

And, again, just to emphasize this point, this is an extraordinary story. The conventional view is that a wealthy, relatively slow-growing country, like the United States, would run trade surpluses exporting capital, and a rapidly growing country, like China, a developing country, would run trade deficits importing capital as capital moves to a country that has higher returns. And there's certainly no shortage of examples where we could find exactly that sort of situation. India today very much fits that bill, a relatively rapidly growing country. It has run trade deficits all but three of the last 30 years, and you could look to the other East Asian countries.

Certainly in the '90s, they had very rapid growth accompanied by very large trade deficits. So that is the textbook story. That is what we should expect to see, and when we don't see that, then I think it's appropriate to be asking questions. And, again, I think the obvious answer here is that China continues to hold down the value of its currency.

And just to make a quick point because it's not as though I think anyone would believe that China is going to instantly move to balance with the United States. If we just take a look at the last two years, China's trade surplus with the United States has increased by \$50 billion, and if you just envision it had stayed the same, apply a multiplier of one-and-a-half to that, that's a difference in 75 billion. That corresponds to roughly 600,000 jobs in the U.S. economy.

So it's easy to make a story where making some progress in terms of keeping, redressing this imbalance in currency, getting China's currency to rise against the dollar, would have very large impacts on the U.S. economy and the U.S. labor market.

Just to quickly get to my second point, this is simply referring to discussions of China in the media, that--and to lump together our economic interests vis-a-vis China--and I'll just highlight a couple points here. We know we have many different economic conflicts with China. So, for example, we have a lot of industries--telecommunications, finance, retail sectors--they would like greater access to China's market. No doubt about it. They're restricted there.

We have industries in intellectual property areas, the software industry, the pharmaceutical industry, the entertainment industry, that would like stronger protections for their products in the Chinese market. Well, when we look at those industries and the demands that

they make on China, that's quite evidently in conflict with the demands we might have in other areas, most importantly the one I was just raising with currency.

In other words, if we hope to get more ground on currency, that means we get less ground on market access, that means we get less ground on intellectual property. So I think there's a real fundamental question here, what do we choose to prioritize? Obviously, different people have different views on that, but I would just make the point that I think in terms of getting the economy to full employment, helping out the labor market, I think there's few things that could take greater importance than getting our currencies in alignment, and again I would argue strongly we are not there yet, even though I will say we've made substantial progress.

Thank you.

**PREPARED STATEMENT OF DR. DEAN BAKER
CO-DIRECTOR, CENTER FOR ECONOMIC AND POLICY RESEARCH**

"The Continuing Problem of China's Currency Management Policy"

**Written testimony of Dean Baker
Co-Director, Center for Economic and Policy Research**

(CEPR) For the hearing on "Assessing the U.S. Rebalance to

Asia"

Before the U.S.-China Economic and Security Review

Commission March 31, 2016

I appreciate the opportunity to address the commission and to discuss what I see as the key issues in rebalancing trade between the United States and China. I will make two main points in my testimony.

First, I will argue that the Chinese yuan and the U.S. dollar remain misaligned. The dollar continues to be substantially over-valued against the yuan, which is the cause of our persistent trade deficit with China. This over-valuation is the result of China's central bank policy; specifically, its holding of large amounts of foreign exchange reserves. The effect of this large stock of reserves has more impact in keeping down the value of the yuan than its recent sales of reserves did in raising or maintaining its value.

The second point is that we must recognize that the United States does not have a single national interest when it comes to dealing with China. Different groups in the United States have distinct interests that are to some extent competing and, in many cases, in direct conflict. The commission must recognize these differences, since government policy will inevitably be forced to prioritize the concerns of some groups over others.

The Value of the Dollar and the Yuan

In recent years, many economists have proclaimed that the imbalance between the yuan and the dollar has been corrected. They have pointed to the sharp increase in wages in China, the rise in the nominal value of the yuan, and more recently the sale of foreign exchange reserves by China's central bank as evidence that the yuan is now properly valued against the dollar and that China is no longer deliberately managing its currency to gain a trade advantage.

There are some basic facts that suggest the opposite. First, as a general proposition we would expect that a relatively fast growing developing country like China would be far more likely to run a trade deficit than a relatively slow growing rich country like the United States. While everyone recognizes that China's economy is slowing, even in the most pessimistic scenarios it is expected to see growth of more than 5.0 percent in the near-term future. This compares to projected growth of just over 2.0 percent for the United States.

The difference in growth rates should translate into differences in returns to investment. In other words, we expect that the average return on capital invested in a country with a 5.0 percent growth rate will be greater than the return on an investment in a country with a 2.0 percent growth rate. For this reason, we would expect that capital would be flowing from the United States and other wealthy countries to China, not in the opposite direction as is now the case.

Of course China does not allow for the free flow of capital, with restrictions in both directions, so we can't know for sure what the flows would look like in the absence of government intervention, but the fact that they are strongly in the opposite direction of what is predicted in economic theory should provide grounds for suspicion.

But the more immediate issue is whether the government is still acting to depress the value of the yuan against the dollar. Here, the focus exclusively on flows is misleading. China had accumulated a massive amount of foreign reserves over the last two decades. While it has sold off some of these reserves in the last year, it still holds more than \$3.2 trillion in foreign exchange reserves.¹ This is far more than the amount that would conventionally be held in reserve to cover any unexpected drops in imports or surges in exports.

The standard rule of thumb is that reserve holdings should be equal to six months of imports. In China's case, this rule would imply that it should hold reserves of roughly \$1 trillion — \$2.2 trillion less than its current holdings of foreign exchange reserves. In fact, this rule of thumb likely exaggerates the amount of reserves that China realistically needs to hold for precautionary purposes. As a large country with a diverse range of exports to a large group of buyers, there is little risk of a precipitous fall in its exports due to a crisis in a major trading partner or a glut of a particular product. Furthermore, a large portion of China's imports are intermediate goods that are used in the production of exports. If exports of manufactured goods fell for some reason, the imports of these intermediate goods would fall as well, reducing the country's need for foreign exchange.

For these reasons, the rule of thumb that reserves should be equal to six months of imports likely overstates China's true need for foreign exchange, but even if this figure is accepted at face value it still implies that the country holds \$2.2 trillion in reserves in excess of what is needed for normal purposes. This is a massive stock of foreign reserves that is pulled off world markets, with the supply of yuan considerably greater than it would be if China's central bank had not acquired these reserves.

¹ Trading Economics. 2016. "China Foreign Exchange Reserves 1980-2016." <http://www.tradingeconomics.com/china/foreign-exchange-reserves> (accessed March 21, 2016).

The excessive stockpile of reserves that China's central bank holds would be expected to drive up the value of the currencies it holds relative to the counterfactual where private parties had to hold these reserves and implicitly there were fewer yuan in circulation. This conclusion would follow directly from an application of James Tobin's portfolio balance theory.² With fewer dollars in circulation in the world and more yuan, investors are willing to pay more for the stock of dollars available to hold and less for the stock of yuan than if the central bank had not intervened.

This is the same logic that applies to the Federal Reserve Board's quantitative easing program, now that it is no longer actively purchasing new assets. While the decision to buy assets during the period of accumulation almost certainly helped to drive down long-term interest rates, the fact that the Fed now holds in excess of \$3 trillion in assets continues to put downward pressure on long-term interest rates compared to a scenario in which private investors had to hold these assets. By putting more money into circulation and reducing the stock of longer-term assets available to the public, the Fed has raised the price of long-term assets, thereby reducing interest rates.³

The Fed's actions can still on net be holding interest rates down, even as it makes a decision to raise the federal funds rate, as it did in December. This is analogous to the decision of China's central bank to sell some of its reserves last year in an effort to support the value of the yuan. While that decision raised the value of the yuan compared to what it would have otherwise been, this does not mean that China's central bank is on net acting to hold up the value of the yuan. The impact of its huge reserve holdings means that the net effect of the central bank's intervention is holding down the value of the yuan.

It is difficult to quantify the impact of the central bank's holdings since there are extensive restrictions on the flow of capital in both directions. In recent months there have been numerous reports of individuals in China who are desperately trying to reduce their holdings of yuan in order to get a currency they view as safer, or at least to diversify their asset holdings. While legal barriers reduce the size of this outflow, legal barriers also hold down the size of the potential inflow of capital from other countries. Undoubtedly, many more foreign investors would opt to invest a portion of their wealth in China if this could be done more easily, especially if they knew they could change their yuan back into other currencies without restrictions. However, a system where China has a freely floating currency implies a qualitatively different economic environment than what exists today. So it is not clear that it would be an appropriate counterfactual for determining a market exchange rate.

Even if there is no simple way to quantify the size of the effect of the central bank's holdings of excessive amounts of foreign reserves, since there is not a well-defined counterfactual, it is

² Tobin, James. 1969. "A General Equilibrium Approach To Monetary Theory." *Journal of Money, Credit and Banking*, Vol. 1, No. 1, pp. 15–29. <http://www.deu.edu.tr/userweb/yesim.kustepeli/dosyalar/tobin1969.pdf>.

³ Just to be clear, the argument is that by holding this large stock of assets the Fed is putting downward pressure on long-term interest rates. This is an implicit comparison of two different stock positions. One in which it had the same federal funds rate, but did not have a stock of more than \$3 trillion of assets, compared with the situation where it does hold this stock of \$3 trillion in assets. Of course if it were to start selling assets, the Fed would be putting downward pressure on interest rates compared to its current position.

relatively straightforward that the value of the dollar is higher and the yuan is lower as a result. Under fairly general conditions, fewer dollars on world markets and more yuan in circulation, will translate into a higher valued dollar and lower valued yuan.

If it is the case that China is still propping up the dollar against the yuan through its policy of holding excessive amounts of reserves, it is certainly reasonable policy for the United States to demand that China allow the dollar to fall by reducing its stock of reserve holdings. The resulting decline in the dollar will make U.S. made goods and services more competitive in the world economy, thereby reducing the size of the trade deficit.

This doesn't mean that the United States should expect an immediate correction in currency values. China is clearly experiencing a difficult transition process which is the main priority of the country's leadership. They are not likely to accept demands for an appreciation of the yuan which will make this transition even more difficult. However, it would make sense to press for a timetable under which the central bank gradually reduces its holdings of foreign reserves, allowing the yuan to rise to a level more consistent market forces.

Conflicting U.S. Interests in China

The discussion in the prior section implicitly assumed that there is a general interest in the United States in seeing a higher valued yuan and more nearly balanced trade with China. This is not true. Much of the workforce would benefit from a smaller trade deficit and the increased employment that would result, especially workers without college degrees who have been the big losers as result of the trade deficit.⁴ This would mean not only more jobs, but higher pay for less-educated workers more generally, as the increased demand for their labor would put upward pressure on their wages. However, there are important interest groups who would be harmed by a rise in the yuan either directly or indirectly.

First among the groups who would be hurt directly are the businesses that profit from importing goods at low cost from China. At the top of this list would be retailers like Walmart who have built up a low-cost supply chain in China and other developing countries by contracting with developing country manufacturers for many of the items they sell in their stores. These retailers would not be anxious to see the price of the items they import from China rise by 15–20 percent in dollar terms as a result of the drop in the value of the dollar against the yuan.

The same story would apply to large manufacturing companies that have set up operations in China in order to produce for export back to the United States. A substantial rise in the value of the yuan would directly lead to a rise in production costs for the items they produce in China. For these groups, an increase in the value of yuan would mean surrendering an important advantage they had developed compared to their domestically based competitors. Both U.S. retailers with substantial sourcing in China and U.S. manufacturers with Chinese subsidiaries producing for export would be directly hurt by an increase in the value of the

⁴ Autor, Dorn, and Hanson. 2013. "The China Syndrome: Local Labor Market Effects of Import Competition in the United States." *American Economic Review*, Vol. 103, No. 6, pp. 2121–2168. <http://economics.mit.edu/files/6613>.

yuan relative to the dollar.

In addition, there are other important interests who could stand to lose if the U.S. government were to press a demand for a higher valued yuan due to the fact they have a competing set of demands they would like to be pressed on the Chinese government. The logic here is straightforward: pressing the Chinese government to raise the value of its currency is asking it to do something it would not otherwise choose to do. Although the Chinese government has indicated an intention to allow its currency to rise and to move towards a system of freely flowing exchange rates, it clearly is not in a rush to change its currency policy. The goal of the U.S. government in this area is to press China to move more quickly.

However, the United States is not in a position to simply dictate a set of policies that it wants the Chinese government to follow. As the second most powerful country in the world, China can very well refuse to act on demands it considers too onerous. It can also make its own demands and expect to get some of them met in exchange for its own concessions.

This matters in the context of negotiations over currency values because the United States also presses a variety of other economic and non-economic issues in its negotiations with China. While I am not in a position to comment on the non-economic issues, I will note several areas in which the United States has made competing economic demands of the Chinese government.

First, the United States regularly presses for more market access in a range of areas. This list includes various areas of finance, including underwriting and insurance, telecommunications, and retailing.

Arguably China has inappropriately restricted the access of U.S. corporations in these and other areas.

The second area in which the U.S. has made demands on China is in the enforcement of intellectual property rights. China has vast amounts of unauthorized copies of U.S.-designed software, as well as recorded music and video material. It also allows for the sale of unauthorized copies of trademarked merchandise, such as designer clothes and watches. And it allows for the manufacture of generic versions of drugs that would be subject to patent protection in the United States.

In these and other cases, U.S. corporations arguably have legitimate grievances under W.T.O rules and other agreements to which China's government has committed itself. However, as a practical matter, China is not going to simply acquiesce to a laundry list of demands from the United States. Any administration seeking to make progress in trade relations with China will have to prioritize these concerns, highlighting some to the detriment of others.

This means that those with competing complaints against China are in a very real way competitors rather than allies. The commission may not wish itself to seek to prioritize the various concerns raised by different interest groups in the United States, but it should nonetheless recognize this reality. Any path forward does not mean that the groups who feel they have been harmed will

collectively beat up China. Rather some of these groups will be working to marginalize the interests of others, in order to get their own concerns moved to the top of the agenda.

Conclusion

To sum up, I would argue that the United States continues to have a large trade deficit with China because of a deliberate decision by the Chinese government to keep the value of its currency at a level that is lower than would be the case without intervention. While it is not currently buying reserves for this purpose as had been the case in years past, its decision to continue to hold a massive amount of reserves has the effect of raising the value of the dollar and lowering the value of the yuan compared with a scenario in which it had a more normal stock of reserves.

The other point that is insufficiently appreciated is that the various interest groups in the United States with complaints against the actions of the Chinese government are in direct competition with each other. There is no plausible scenario in which the United States is going to be able to impose its will on China in a wide variety of areas. This means, for example, those who hope to see China make major concessions on the value of its currency are in competition with those who would like to see China open its markets to U.S. firms in various sectors or increase its protection of U.S. copyrights, patents, and trademarks. More progress in one area will come at the expense of progress in other areas. The commission may not choose to set priorities, but the administration and Congress cannot avoid this need.

PANEL II QUESTION AND ANSWER

HEARING CO-CHAIR TALENT: Thank you, Dr. Baker.

All right. I have Commissioner Wessel, then Fiedler and then Wortzel on the list so far. So Commissioner Wessel.

COMMISSIONER WESSEL: Thank you and thank you to our witnesses.

I probably have an hour or two of questions, which I'll try and put into five minutes, and Dr. Goodman and Dr. Economy, I will make no bones about the fact that I think that you're arguing theory where the facts on the ground are painting a very different picture, and I think that has come home to roost this year in the political debates where outdated theories, some of which are being broken, Tufts, Dr. Autor, many others, have argued that our traditional approach on trade matters is not, again, the facts are showing a very different approach.

Dr. Economy, I saw your face when Dr. Baker indicated the potential job loss from trade deficits, assuming you were making a face at his job loss--well, then, I'll take that back.

TPP was supposed to be about writing the rules so that China didn't get to. The comment earlier about all of the countries rushing to be members of TPP shows that it's somewhat of a sweetheart deal for them. It's not about imposing harsher standards or world-class standards, but it's about access to the U.S. market.

ACTPN, which is the highest level advisory committee to the president on trade, in fact, criticized the provisions in the TPP on SOEs, not only for grandfathering all existing subsidies in until entry into force, but for a very lengthy injury standard of a year or more under normal circumstances, and no definition of what commercial activities, in fact, are.

Others have criticized the rules of origin, which would allow for 63 percent of an auto produced in a TPP country to consist of Chinese materials and still be stamped with "Made in TPP" for purposes of the preferences in the agreement.

The currency provisions, which are in a side letter among the finance ministers, is not in the core text of the agreement, is not subject to dispute resolution. So, you know, I'd argue to you that, yes, TPP is about enhancing U.S. investment in the region and strengthening relationships in that way, but it will not advantage U.S. workers and domestic production here, and as a result is going to create enormous continuing imbalances similar to those that we have with China right now that are only increasing rather than decreasing conflict.

So with that, I'd welcome a response and any information that would counter what I just said. Dr. Economy, do you want to start?

DR. ECONOMY: Let Matt start. Go ahead.

MR. GOODMAN: All right. Happy to take a crack. So I totally agree with you that we should live in the real world and not in the theoretical world, and certainly that's what I do in analyzing these issues, and in that context, I think in an imperfect world, TPP is not bad. It's not perfect. It doesn't do everything. It doesn't solve every problem, but I think it's very hard for me to feel that TPP does not improve both sides of what it's trying to do, which is to increase market access for U.S. exporters, which I think it does. 18,000 tariff lines are being cut. You know, a lot of--

COMMISSIONER WESSEL: We're exporting a lot of whale meat right now so--

MR. GOODMAN: Well, we do that, too, but we export other things. And on the rulemaking side, it clearly establishes tougher and new disciplines in areas like state-owned enterprises where there was nothing. So it seems to me, at a minimum, it's better than the

previous status quo in terms of what it accomplishes.

In terms of the cost of TPP, again, I think I would actually agree that the administration has probably overstated the net job benefits of TPP. You know, as an economist looking at these agreements, I'd say that the actual net job gains are probably going to be pretty flat, pretty neutral.

But, in theory, it produces better jobs, and over time I think that that's been proven to be the case with trade agreements, that you get better jobs, not necessarily more jobs. And that's the bet we're making.

Now, as far as those, Autor and the other authors you mentioned, that's very powerful work, and my understanding of the argument is that the transition periods, particularly regionally from trade disruption, are taking longer than theory suggests or than previous analyses have suggested, and that is certainly very powerful analysis.

But even those authors don't suggest that we should really be fundamentally doing something different about trade agreements. They say we shouldn't be protecting markets or denying ourselves the benefits of trying to engage more competitively in a globalized economy, which I think would be clearly more damaging to our interests.

So to me, the question is how do you address those transitional costs more effectively? And that to me requires much more thinking and much more money, frankly, devoted to education, retraining, new job opportunities here in the United States.

I think that's a fair point, but again when something is a good for the broad benefit of most Americans but has costs and risks associated with it, I think the best way to deal with that is to try to maximize the good and then take on directly the costs and risks, and that would be preferable by far than trying to cut off the good benefits of something like what TPP is trying to achieve.

Sorry to ramble on.

DR. ECONOMY: I think Matt said it well and better than I could have said it. I will only point out that in the analyses that I've read of the TPP by the Peterson Institute, by Jagdish Bhagwati, suggest that the United States will gain \$78 billion in exports, that the job churn will be roughly equal to what it is today, that there won't, in fact, be a net loss in jobs, but as I mentioned in my comments, I think the impacts are still under debate and discussion, right, and as with all trade agreements, there are going to be winners and there are going to be losers. And so certainly there are going to be imperfections in the agreement, but that's what an agreement is, right, a trade agreement is?

It's all about the give and take within a country and among countries and as I guess a measure of whether you believe, as Matt has stated, that overall the greater good is served by the TPP, and there's a greater win for the United States in acceding to it.

COMMISSIONER WESSEL: Dr. Baker, any thoughts?

DR. BAKER: A couple quick points. First off, you know, again, referencing Dr. Goodman's point about doing more to help workers in transition, I was at a talk at the Peterson Institute talking about that just this week, and someone made the obvious point that everyone there was sort of saying we have to do more to help workers in the transition, but everyone realistically knows that's not going to happen.

So you're asking a lot of people that, you know, they're going to be facing the transition without the help. As much as we, whoever we might be, might like to see that happen, it won't happen.

The other point is simply, you know, again, getting back to a point earlier, I was

saying there are tradeoffs. One of the major emphases of the TPP is stronger protection, intellectual property protection, patent and copyright related protection. That means more money coming to the United States for patents and copyrights. That means, again, just the normal trade theory, and even using the Peterson model, that means we'll have a bigger deficit on other trade, particularly manufactured goods.

It's one of the things that I always find perplexing, that so many people are perplexed by the upward redistribution of income. When we continue to make patents and copyrights longer and stronger, we're engineering the upward redistribution of income. Now we may think that's a good thing, but we shouldn't be surprised by it, and this is a step in that direction.

COMMISSIONER WESSEL: Thank you.

HEARING CO-CHAIR TALENT: All right. Thank you. We ran over, but that's all right. It's a really important subject, and we do have some time, but we'll ask everybody to try and stay reasonably within the five-minute limit.

Commissioner Fiedler.

COMMISSIONER FIEDLER: I will stay within my five-minute limit. I'll deal with the TPP in the following way. If you don't think the political context of negotiating trade agreements in the United States is different from what it was 25 years ago, you're not reading the paper or watching the news. Okay. There are some very ugly things happening as a result of people not being able to make the transition. So you better come up with some better arguments or the political context is not going to change or be reasonable from anyone's point of view.

I want to get back to the rebalance, Chinese intentions, Chinese stability, the Chinese economy as it affects stability, and the role of stability in what we might characterize as Chinese adventurism or assertiveness militarily, like we had this morning. I want to sort of merge the two considerations, and I think it goes back to intentions. So we don't know the decision-making process in China at a high level. We have a feeling that Xi has consolidated in a way that no one else has in the last 25 years.

We think that stability is driving the lack of, quote-unquote, "reform," and we have a phenomenon that exists that hasn't existed or certainly didn't exist in the optimism of the American corporate community when they were pushing PNTR, which is a very aggravated aggressive posture towards U.S. company operations in China in a way that we haven't also seen.

All these things are mixed together in a dangerous way, it seems to me. The stability problem driving adventurism perhaps to divert attention. What are your thoughts about this?

DR. ECONOMY: Okay. So that's a really big overarching question. Let me take a stab at it this way. I think to understand Chinese intentions, you don't have to look--I'm just going to use Xi Jinping because I think actually we should not be so confident that he has completely consolidated power. I think structurally, bureaucratically, he's done an extraordinary job of consolidating power, but increasingly I am hearing that there are significant fractures within the Chinese leadership, and we should be paying attention to these as well.

COMMISSIONER FIEDLER: Well, he certainly seems nervous. Small things make them very nervous.

DR. ECONOMY: Absolutely. But just in terms of Chinese intentions, let's focus on Xi Jinping. I think, you know, he articulated well with his Chinese dream and rejuvenation of the Chinese nation; right? What does it mean? It means he wants a robust Chinese Communist Party at the forefront of the political system, he wants a modern and innovative Chinese

economy, and he wants a PLA that is capable of fighting and winning wars.

And I think if you look across the board, he's made significant progress on all of those, but not enough progress; right? And I think--so if you look at what he's done in terms of the Chinese Communist Party, right, he has his anti-corruption campaign. The problem with the anti-corruption campaign is that it's produced a certain level of paralysis, right, paralysis in terms of willingness to undertake reforms, right, willingness to move forward to be adventurous, entrepreneurial, right, in the economic front.

Local officials are afraid that if they take risks, they're going to get their heads chopped off. So you have sort of a mixed effort underway. On the one hand, you have a very sort of rigid and repressive political system emerging under Xi Jinping that is hampering what he would like to turn into a more modern and innovative economy.

I think he's also unclear about the degree to which he's willing to loosen control in the Chinese economy. I don't think he has, really when they talk about the market, when you look at the range of reforms in the Third Plenum of the 18th Party Congress, they've made very little progress in terms of advancing those reforms. Why? I think in part not only because they're difficult, but because Xi Jinping himself and some of his advisors are unwilling to loosen the hand of the state, right, because loosening the hand of the state means loosening his own personal control; right?

You're introducing uncertainties and unknowns when you introduce the market. And he can't, he won't be able to affect, right, the economic system the way that he would like to. So I think there's that element.

In terms of--let me just quickly say, in terms of the stability versus the adventurism abroad, I think we're not quite there yet where stability, a desire for stability, concerns over stability are producing adventurism as a way of distracting the Chinese people. It's a possibility.

I think the adventurism is coming because this has been something that's been on the books since the early 1980s, you know, Admiral Liu Huaqing talking about reclaiming the South China Sea. That's been there for a long time. So I think Xi Jinping is moving from staking these claims to realizing them.

So I don't see this as an adventurism born out of a concern over stability at this point. It could turn into that, but, at this point, I think it's just part of his overall drive.

COMMISSIONER FIEDLER: Anybody else? Okay. Thank you. Oh, go ahead.

MR. GOODMAN: Liz is the real China expert so I don't have much to add. Just to say that, of course, intentions are always hard to determine, but from their behavior, you can see they're doing things differently from what they used to do, and that includes domestically in the economics space, they are making it more difficult for our businesses. There was a survey by the American Chamber over there showing that 75 percent of American companies feel unwelcome now in China.

It's a very different perspective from when they went into WTO. So that's one change. And their external behavior, as well, is clearly different. And I wanted to just highlight the point that Liz made about to make the economic transition that they need to make domestically, they need to let go, and they're moving in the opposite direction, and I think that's a fundamental tension. That is the fundamental tension for China, and I don't know how that's going to come out, but it's like an unstoppable force against an immovable object. Something has to give.

DR. BAKER: I'll just make a quick comment. I certainly will claim no expertise

in China's internal politics, but just from the economic perspective, although the economy is clearly slowing, no dispute about that, the most pessimistic estimates I've seen still show the economy growing at a five percent annual rate, which is hardly a crisis by most measures.

COMMISSIONER FIEDLER: Right.

Thank you.

HEARING CO-CHAIR TALENT: Dr. Wortzel.

COMMISSIONER WORTZEL: Dr. Goodman, I want to take issue with one point you made, and I think in doing so, I'm going to give Dr. Economy a chance to demonstrate her knowledge of domestic Chinese political affairs. And then I have another comment about the bilateral investment treaty.

But you, you questioned, Dr. Goodman, the competence to handle the rebalance of its own economy in Beijing, and I would suggest to you that they really have I won't say a ton but, you know, per capita, they have loads of very competent, knowledgeable, Western-trained and Chinese-trained economists, and they're both in the government and in the Party and in academic institutions.

So it seems to me that it's not the competence to handle the rebalance. There's plenty of competent people. It's the political will and the ability to overcome internal Party and provincial factional problems and political troubles. And that's where I think maybe Dr. Economy might want to discuss that a little.

On the bilateral investment treaty, I mean I don't understand why anyone would think that if China goes out of its way to avoid its World Trade Organization obligations, it's going to suddenly-- what indications are there that it's going to change its policy to meet its obligations under a bilateral investment treaty?

I mean it seems to me you're just going to see all kinds of other domestic regulations designed to avoid meeting obligations. And I'll let any of you comment on that.

MR. GOODMAN: Can I just quickly say something before letting--again, you're right to point to Liz as the one to talk about domestic politics, but I would just clarify. I think in my oral statement I had to sort of truncate a little bit of my point. I intended to say that there have been people who have questioned their competence. I actually agree with you. In fact, I wrote a newsletter three days ago, which I'm happy to submit for the record, precisely saying I think competence or incompetence is a red herring.

I think that's what a lot of people are saying, but I actually believe there is something else going on. Either the challenges are much more difficult than they thought or they don't want to move ahead with market-based reform--the political authorities--and so they're constraining the economic policymakers, who I agree with you have shown for 35 years tremendous competence. So I just, I apologize for in my oral statement suggesting that that was my view. I meant to say that's what people are saying.

DR. ECONOMY: Thanks very much.

So I guess I would say, you know, yes, they are competent, but, right, I think it's a matter of the politics sort of stifling the competence, and so I think there are a number of things going on.

First, I think there are conflicts within even the Standing Committee of the Politburo over how to drive economic policy forward. As I understand that you have differences of opinion, you know, with Li Keqiang and Xi Jinping, right, the Premier and the President, and, of course, we know that Xi Jinping has tried to subvert traditional lines of power in terms of economic policymaking and sort of control it for himself.

At the same time, Wang Qishan, who is in charge of the anti-corruption campaign, apparently has a kitchen cabinet of economic advisors that are often in conflict with what Li Keqiang wants to get done. So you have numerous power centers within the top leadership that don't necessarily agree on the path forward.

I've also heard that Xi Jinping himself doesn't really understand economics, and that this is a problem, and so when you want to get something done, the way to get him to move forward is to have it appeal to sort of China's role in the world. So something like One Belt One Road is very appealing to Xi Jinping as an initiative or having the Chinese currency get into the SDR is very appealing to Xi Jinping.

And then a final thing that I've heard--these are all, you know, sort of internal political things--is that nothing gets done when Xi Jinping travels. That part of the challenge of having had him assume so much power, personal power, is that he really has become a kind of logjam in economic decision-making, and he travels a lot. So I think there are a number of factors, and that's just at the most elite level, I think, that are problematic.

In terms of the bilateral investment treaty, you know, for me, look, we're not going to negotiate a bilateral investment treaty that doesn't serve our interests, right, and what we're looking for is getting access, right, to all of those sectors of the Chinese economy that Dr. Baker mentioned we don't have access to at this point in time.

And so the extent that we continue to push forward, I think it's only to our advantage, right, and what do we lose from trying? You know our economy is much more open, we have only to gain, as far as I'm concerned, and I think there are elements within the Chinese sort of economic elite that clearly see the opportunity to have competition with the United States as something that will benefit their own internal reform process.

HEARING CO-CHAIR TALENT: Thank you.

Oh, our Vice Chair is next.

VICE CHAIRMAN BARTHOLOMEW: Thanks very much, and, as always, I have a statement as well as a couple of questions. I have some specific questions for several of you, and then a more general question.

Mr. Goodman, I just think I have to start out by saying that I just disagree with you about this issue about better jobs with trade agreements. There are some people, I think probably primarily people on Wall Street, who have seen increases in their incomes and increases in their opportunities because of some of this trade, but if you look at what has happened, not just to individual people who work as manufacturers, but what has happened in their communities, it's really, really difficult to say that there are better jobs.

You know these are middle class people who are no longer middle class, who if they can find jobs can only find jobs in the service sector that pay them a quarter of what they were making, and it's very important to do job training, but you can train people for jobs, and if the jobs don't exist because the local economy has been destroyed by the closing of the plant, it's not going to accomplish what we need to accomplish. So I'm going to just agree to disagree on that point in particular.

I do want to note, though, I was very interested to see that you put as one of your four things that there needs to be a U.S. vision and plan for infrastructure investment in Asia and again have to note, we really need a plan for infrastructure investment in the United States and particularly, I mean I live in Washington, D.C. My car is a mess because our roads don't work, and it would be very hard to convince the American people who see what's happening with our own infrastructure that we should be investing more in infrastructure overseas.

Okay. Now to my question for you, and then I'll say the other questions, and then we can go through answers. You mentioned that we need to incentivize countries to follow the U.S. lead and to impose costs on bad behavior. So I'd like some specific examples of what you think needs to be done in those contexts.

Dr. Baker, for you, I'd like to get your sense of how China's currency manipulation affects the countries in the Asia-Pacific, particularly the ASEAN countries, so that we're talking not just about the obvious impact here in the United States, but in the region.

And then for all of you, you know, earlier this morning, people mentioned that the strategic objectives of the rebalance overall are kind of--I'm going to call them fuzzy. I mean they keep changing; they keep shifting. And we've seen over the years a problem with establishing what the strategic architecture for the U.S.-China relationship should be, and we have to think about that as we talk about the rebalance.

So one of the questions on the economics is how do we determine whose economic interests are the interests that we should be focused on, and you sort of touched on them, Mr. Goodman. But just as an example, a lot of U.S.-China policy since the beginning of the MFN debates has been driven by Boeing and other major multinational companies really. And I just note that Boeing just announced that it's going to be cutting 4,000 jobs, most of them primarily in the commercial aviation sector, which again is a major source of middle class manufacturing jobs here in the United States.

So how do we, how do we, if what we need to do is we need to clarify what our strategic objectives are in the economic relationship in the rebalance, as well as in the over relationship, how do we do that when we talk about economic interests? So there you go. A bunch of questions.

MR. GOODMAN: Okay. I'll start on some of that. Actually let me get the infrastructure one out of the way because I did say in my remarks that the first thing that we need to do is invest in our own economy, and that includes in infrastructure, and as for investing in infrastructure overseas in Asia, I'm not suggesting large amounts of money. In fact, that wouldn't be realistic. It's not what we do best, and that's not what we need.

We need to bring our, the rule of law, our good corporate practices, our ability to address some of the underlying impediments to infrastructure investment in the region, and then to collaborate with other countries like Japan that are putting big money behind this. So I don't suggest that we should be spending a lot of U.S. money in that endeavor, but I do think we need to have a vision and a plan because it's a huge need in the region, and there's a huge demand for that, and the U.S. is not planning where others are.

In terms of incentivizing, and addressing bad behavior--so on the incentive side, I think TPP is an example where we have clearly shown an ability to draw countries in to high-standard rulemaking efforts that they feel are in their interests. I agree with an earlier comment that a lot of what people want is access to our market, the largest in the world, but they also want greater discipline in their own economies.

I mean that's clearly the case in Vietnam. They wanted this outside pressure, as it were, to help promote their own domestic reforms, and that gives us an opportunity to incentivize them to join.

Bad behavior, I think we should be willing to use the WTO more aggressively, use our own domestic laws where they're consistent with the WTO. I'm not a huge fan of reciprocity per se. As your former chairman I think said in his dissent in last year's report, I think that's a slippery slope or it's problematic if applied in certain areas, but there might be ways

in which we could be a little more clear about where we are willing to accommodate Chinese interests where they're not accommodating ours. So I think there is room for creative thought there. I don't have a clear answer.

And then, you know, I think it's true, we have to weigh the national economic interests, broadly undertaking these efforts in Asia, and that involves a lot of different stakeholder interests, and certainly that has to be part of the effort, and we need to consult widely and ensure that everybody's interests are being accounted for.

I think, broadly speaking, we have been doing that, notwithstanding the views that I know are different up there, but I believe that we need to always be ensuring that we're broadly looking at U.S. interests and pursuing those in our strategies.

VICE CHAIRMAN BARTHOLOMEW: Dr. Baker.

DR. BAKER: Okay. You'd asked how China's currency policy affects the other countries of the region? I remember looking at this some years back. I haven't looked at it recently and followed it as closely, but in the past, these countries have basically pegged their currencies in a certain sense against China's currency. So as their currency is pegged against the dollar, and they're keeping it down, the other countries in the region did that as well, and I remember there was a time, and I'm forgetting, I believe it was in September or August of 2005, where China announced, so it was an open move of their currency, and all the others moved in conjunction with it. So it was very, very clear that they were basically pegging to the Chinese currency.

So what that means is people often say, well, if we reduced our trade deficit with China, it would just be with other countries. Well, no, in that case, the trade deficit was increasing with all those countries because they were all moving together against the dollar. So, again, I can't say how rigidly that applies today, but it, certainly it was very, very clear in the data a few years back.

If I could jump ahead to your next question on whose interest, you know, that was the point I was trying to raise, that we have to recognize we have competing interests for different groups, and, again, I'll just highlight the point I was making before in terms of intellectual property. The Peterson Institute Model that we've all been referring to here, one of the nice assumptions, I think an inaccurate assumption, but a nice assumption for this purpose, is it assumes that trade deals don't affect the balance of trade.

And if you think about that for a moment, if we're getting more in royalties and licensing fees for Microsoft's Windows, for Pfizer's drugs, for Hollywood's movies, then we have larger deficits in everything else. So we have to have priorities, and to my view, that's a totally skewed priority. We should be looking the other way.

DR. ECONOMY: I'd just like to make one point on the infrastructure point, and that is to say that we may not be competitive when it comes to building roads and railroads, but we do have some comparative advantages in some areas of clean energy, telecommunications, agriculture, whether we're talking about agricultural equipment or seeds, right, and so I think we shouldn't sort of count ourselves out of the game when we're thinking about competing against China in its OBOR strategy completely throughout Asia because I think we do have some advantages, and I think we can couple our sort of economic advantages with our civil society aspects, as Matt was suggesting.

We can partner with our NGOs, like the Asia Foundation and National Endowment for Democracy and IRI that work on rule of law or on property rights. Right? There's a lot of nice symbiosis, for example, between property rights development in Burma,

Myanmar, and gaining access for agricultural companies. So I think if we think strategically, right, partnering to our strengths, I think we can actually make some real progress.

VICE CHAIRMAN BARTHOLOMEW: One other comment. I don't think, I don't think we do enough as the government to also talk about the quality of our products. When we were in Vietnam, we heard complaints about the rail project in Hanoi, which is one example. China is financing it. It's over budget, it's over time, and the Vietnamese are already seeing that it's inferior quality, and I think we need to focus more on the consistency of the quality of American product, and that while it might cost a little bit more at the beginning, it will stand you in better stead as we go along the way.

HEARING CO-CHAIR TALENT: All right. I have Commissioner Tobin and then Commissioner Cleveland, and after that, it's looking like we'll have some time for a second round. So Commissioner Tobin.

COMMISSIONER TOBIN: Thank you. Thank you, all.

Each of you has suggested that we need to, in the next administration, Dr. Goodman, you called it do a reboot on the economic strategy, and I think, Dr. Economy, you might have said a new economic narrative is needed, and certainly, Dr. Baker, you too think we need to kind of relook at things.

I'd like to start with Dr. Goodman. You outlined several strategies in your written testimony, and having worked at Hewlett Packard and IBM, I'd like to hear if your second strategy would be to put a much stronger priority on sustaining U.S. technological primacy. You mentioned a few things that you would do there, but can you expand on that and convey who would do what and what you think would be our smartest first step out?

MR. GOODMAN: Okay. The basic point I was trying to make is that we have to succeed and win in technology. This is our strongest area of comparative advantage so part of the purpose of flagging that is simply to say that has to be kind of job one for an administration in thinking about how to do that.

In terms of the specifics, I think it involves, as I say, investing in basic research, providing the same kind of open environment that enables innovation to flourish here in the United States, and then it requires, you know, our ability, our willingness to take strong stands on things like intellectual property theft, on data localization, on forced technology transfer in other countries, which we do through a number of different means, and we need to redouble our efforts across all of those areas.

And I think the internet is a really important area, a battleground going forward, where there are some countries that want use a concept of internet sovereignty and having the state much more involved in directing the internet, and I think that is very much not in our interest, and we need to be working with allies, in particular, like Japan and Korea and others in the region, who--and Australia, who don't agree with that and are going to be more supportive of our position.

So I think there are a number of things, but the main point is to say, you know, this has got to be priority one.

COMMISSIONER TOBIN: So those strike me as incremental steps. Have you thought about anything different than what we've done before that would be a notch above that with broader impact?

MR. GOODMAN: The answer is no in terms of my having a specific new idea, but I think all of these things are part of the answer, and I think we need to find more robust ways of promoting all of those activities going forward.

As I mentioned, we've got a commission underway, chaired by Jon Huntsman, Charlene Barshefsky and Evan Greenberg of Chubb Insurance, and we'll be producing, I hope, more specific ideas like that late summer.

COMMISSIONER TOBIN: Okay. I'll look forward to that. Dr. Economy, your thoughts on technological primacy and what we can, as we reshape or strengthen our economic narrative, what would it be?

DR. ECONOMY: Probably not an issue that I've thought a lot about, but I guess, you know, certainly it can begin with investment in our basic scientific research, all the way to ensuring that when we have new developments that we have a mechanism for scaling them up and financing for scaling them up and bringing them to market, that our venture capital system is working well to enable that process.

I think, when I think about it in terms of China, I think that we need to be constantly pushing back against Chinese efforts at indigenous innovation. I think that's an element where the bilateral investment treaty can play an important role. So I think we are the leading innovation nation, as far as I'm concerned, in the world, and I guess it begins with education through on up.

I don't have any major new thoughts on this. I think we know what we need to do. It seems to me it's a matter of financial investment and capacity and will.

COMMISSIONER TOBIN: Dr. Baker.

DR. BAKER: Yeah, I'd just say a couple of things. I mean I think again the main focus has to be domestic in terms of improving our abilities there, basic research, certainly very much so.

The other point, I apologize for keep hitting on this, but I really do think we need serious reform of the patent system, and this has been raised by increasingly the White House. The Council of Economic Advisors just, I think, put out a very good report on this that we have so much patent trolling, that it's really--

COMMISSIONER TOBIN: Right.

DR. BAKER: --come to obstruct the development of new technologies in many areas so I really do think we need a serious overhaul.

COMMISSIONER TOBIN: So let me just close my time by saying we've done this before when the Japanese were eating our lunch in the '80s, so personally I'd like to see us pull it together, as you said, Dr. Goodman, and be smart as we go forward.

Thank you.

HEARING CO-CHAIR TALENT: Thank you.

Commissioner Cleveland.

COMMISSIONER CLEVELAND: I'd like to go from the macro to the micro, or maybe not so micro, and I'm interested in your thinking, all of you, about the Asia Infrastructure Bank that just appointed the five new vice presidents, which was a fascinating group of individuals. The president of the bank has gone on a world tour, the likes of which I don't think I've seen even our, the World Bank president here go on.

So I'm curious what your thinking is about how this fits into China's economic strategy, and if you would speculate sort of five, ten years from now where you see their critical investments, how you see China influencing those investments, and how its presence may or may not shape what happens with ADB and the World Bank?

MR. GOODMAN: Okay. Since I didn't address that in my remarks, but I have views on that subject, I'm happy to give a quick summary of that. So I think, let me just say for

the record, the United States completely mishandled the AIIB event and--

COMMISSIONER CLEVELAND: I was trying not--

MR. GOODMAN: --I yield to no one in my criticism of the administration--

COMMISSIONER CLEVELAND: Yeah.

MR. GOODMAN: --for the way it handled the AIIB rollout. However, I think the instincts were right. I think there were reasons to be concerned about what China was doing and how it was doing it. There are important disciplines involved in multilateral lending in this area, whether environmental or social standards, debt sustainability questions, open procurement practices, and I think there were real U.S. interests involved in this, and our questioning of this initiative was legitimate, plus just the matter of do we really need another bureaucracy to do this kind of business? We have the World Bank and the Asian Development Bank, and those are already bureaucratic institutions that have various challenges.

So I think we had the right instincts, but we just, we muffed it, and we should have done a better job. In the end, though, in my view, I have an alliterative sound bite on the AIIB which I use: the AIIB, I think, is going to be smaller, slower and more similar to the ADB than the Chinese hoped or than we feared.

And so because if they're going to do this in the lean, clean and green way that they say they're going to, then it's going to take them a lot longer to find good projects to lend to and to do the due diligence necessary, and so I actually think the AIIB by itself is not going to be an enormous problem. It's going to--and plus there are so many other participants from Europe and elsewhere who are going to be keeping an eye on all this and the markets will as well.

But the broader intentions of China to push out in this area is something that will continue, and I think we have to watch and be involved and handle it better next time.

DR. ECONOMY: Now I broadly agree with Matt. I guess I was saying earlier that I think it's important for us to be able to distinguish between an AIIB and ADIZ, and the AIIB does not necessarily have to pose a threat to U.S. interests. The infrastructure demands within the Asia-Pacific are enormous, and the AIIB can be a positive force in contributing to meet those needs.

I think the key question is, you know, what are the standards going to look like, and Jin Liqun has said it's going to be lean, green and mean, and so--

MR. GOODMAN: Clean and green.

DR. ECONOMY: Green and mean.

MR. GOODMAN: Not mean.

DR. ECONOMY: No, I've heard mean. I've heard mean. Lean, green and mean. And if so, then that's a positive sign, and, again, as Matt noted, there are many other participants, and I think the eyes of the world are on the AIIB, and if it succeeds, then I think that's terrific, and if it, you know, doesn't hold up higher standards, it's going to come under enormous amount of criticism.

So I think what we should be looking for at this point is partnerships. I think there's already one partnership agreement on the books between the ADB and the AIIB, and I think we should at this point stop talking about how we mishandled it, which we did, but look to the future about how we can work with the AIIB to meet the needs of the region.

DR. BAKER: Yeah, I would largely agree with Dr. Economy and Dr. Goodman. I mean to my view, at the end of the day, this is a positive. This is an area that badly needs more infrastructure spending. This might not have been the ideal way to get there, but it is likely to lead to more spending, and if this encourages competitive assistance, that to my view would be

great.

HEARING CO-CHAIR TALENT: Thank you.

I have one quick question, and then I have Chairman Shea, and then I think we'll have time for one first round or second round question. Mr. Fiedler is indicating one.

So, Dr. Baker, I'd like you to explain a little bit more your argument about how China's holding American dollars lowers the value of the yuan, and I'm not challenging it. Currency policy is not, you know, my forte, but is the argument that by holding so many dollars, they pull dollars out of circulation, which increases the value of the dollar relative to the yuan?

In other words, you're saying it's not so much that it holds down the price of their currency as it increases, artificially increases, the value of American currency? Is that the argument? Feel free to explain.

DR. BAKER: Yeah, no, that's exactly the argument. So it's holding up the dollar now vis-a-vis their currency, vis-a-vis other currencies as well, but most importantly their currency in this context.

And, again, I keep using the analogy with the Federal Reserve Board holding bonds so we have this stock of U.S. government bonds, other mortgage-backed securities, let's say ten, 12 trillion that form that whole base, and we have three trillion of those, or three-and-a-half trillion, I think it is, sitting at the Fed. Well, same story. We have however many dollars in some sense floating around the world, and China is sitting on over three trillion of those; whereas, if they had more normal, at least to my view, foreign exchange, foreign reserve policy, it might be closer to one trillion so we'd have another two trillion floating around, which people would presumably eventually hold but at a lower price.

HEARING CO-CHAIR TALENT: Well, the precise way to think about this is it's artificially strengthening the dollar.

DR. BAKER: Yeah.

HEARING CO-CHAIR TALENT: And so actually if that's true, then it's probably contributing to some extent to a trade imbalance with all other countries; right?

DR. BAKER: Absolutely.

HEARING CO-CHAIR TALENT: That's your argument?

DR. BAKER: Yeah.

HEARING CO-CHAIR TALENT: Okay. Thank you for clarifying that. Chairman Shea.

CHAIRMAN SHEA: Yeah, but, Dr. Baker, aren't they, when the Central Bank takes the dollar, it takes the dollars in, they're putting out, they're exchanging RMB for the dollar so they're increasing the supply of RMB so that reduces the value of the RMB because there's more in circulation?

DR. BAKER: It lowers the value of their currency as well, yes.

CHAIRMAN SHEA: Yes.

HEARING CO-CHAIR TALENT: And I didn't mean to cut the other two panelists off if you'd like to comment on it. Could you--if you don't mind, Mr. Chairman--could you elaborate on that a little bit? So in other words, they exchange it, and again I wasn't kidding when I said this is not my forte so break it down.

DR. BAKER: So let me hold out the counterfactual. The counterfactual is that they're holding say a trillion dollars of reserves, and in that story what they've done is they've put out a lot more of their currency into the world. I'm sorry. I'm sorry. They would have put out a lot less of their currency in the world, and the value of their currency would have risen because

people are trying to acquire it.

Now, it's not freely traded currency so it's a little complicating that story. But basically people are trying to acquire it. So the yuan would be higher relative to other currencies; the dollar would be lower.

HEARING CO-CHAIR TALENT: Okay. If you wouldn't mind, after the hearing, give our staff--I'm sure you've written on this in length--so give us the best thing you've got in terms of breaking it down because I'm quite interested in what--

DR. BAKER: Okay.

HEARING CO-CHAIR TALENT: Thank you.

CHAIRMAN SHEA: Okay. I'll go.

HEARING CO-CHAIR TALENT: Sorry.

CHAIRMAN SHEA: No problem. TPP. Let's go back to TPP. I don't give a lot of thought to this issue, to be honest with you. But it seems the argument is more one of credibility than economics--the supporters of TPP. You know, yes, Peterson has a study, but every--you know, I've been in Washington enough. Everybody has got a study--long enough. Everybody has got a study, and some say one thing; some say another thing. But fundamentally, it boils down to U.S. credibility. That's what I--in the region. Is that a fair--for those who support TPP? Yes, you think it produces benefits and will have economic benefits, but the preponderant concern is U.S. credibility in the region.

So that's what I get from both of you. So let's say TPP doesn't pass, okay, doesn't get ratified here in the United States. I mean you have the four presidential candidates on both sides--Hillary Clinton, Bernie Sanders, Donald Trump and Ted Cruz--none of them support TPP. So it seems, it seems like it's sort of hanging on a thread here in Washington.

But even if there is no TPP, the security logic will still be there in East Asia. There will still be, the countries of East Asia will still be drawn to the United States because of just what's happening on the security, in the security arena.

And also, I mean China's economy, I'm not optimistic about China's economy. David Shambaugh has an interesting book out about China's future and said if China doesn't change from its sort of current authoritarian posture, it's unlikely to be a powerful economic force or as powerful an economic force going forward.

So if the idea about the TPP is to sort of battle China for economic supremacy in the region, the fact that China seems to be staying on a path that is not conducive to reform and to become a more vibrant economic power kind of takes that way.

So I'm just wondering what your thoughts on what I just said? Anybody.

MR. GOODMAN: Okay. Good set of points. I think right now credibility is the biggest factor. Failure of TPP would definitely be a huge blow. I was in Japan and China last week, and there is just no question to me, this would be a huge blow to our credibility.

But as I said in my remarks, there are three positive reasons for our doing TPP. The economic ones I would agree with you are not going to bend the arc of our economic future. They're not that big, but they're significant. Half a percent of U.S. GDP is a real number, and I think that estimate by a very respected economist is a credible one. It's very well documented and researched, and I personally believe it. I agree it's not going to change our economic future, but it's significant.

The other two factors are also very important. The third one gets to one of your other questions. The second one is the rulemaking. I think we have a real interest in higher standard rules in the region, and TPP helped to improve those rules. There's more to be done in

trade and elsewhere, but I think that was a very important reason to do TPP beyond the pure economic ones.

And, then, finally, it imbeds us in the region, as I say, and to your point about security, yes, Asians want us there for our security presence. No question. But they don't only want us there for that, and, in fact, if it's only that, they feel uncomfortable. They don't want us to just be a military force in the region. They want us to be engaged economically.

We've always been engaged economically, and this is something that has been the sharp end of our spear of our engagement in the region.

CHAIRMAN SHEA: It's not TPP and no engagement, economic engagement. It's not that type of choice. It's no TPP and other forms of economic--

MR. GOODMAN: Yeah, but TPP is the most profound form of economic engagement that we have done in East Asia--

CHAIRMAN SHEA: Okay.

MR. GOODMAN: --since the Marshall Plan.

CHAIRMAN SHEA: Okay.

DR. BAKER: I'd just say as an economist, I get a little worried when you see an economic policy being advanced on political grounds, and it doesn't mean they're wrong; I just get a little worried.

The other point I would just say about that, you know, I grew up in the Vietnam War era, and when it became clear to I think most people that this was a really wrongheaded enterprise, the last argument for keeping us there was we had to maintain credibility. I'm not sure it makes sense in general to do something that isn't otherwise justified based on the need to maintain credibility.

CHAIRMAN SHEA: Okay. Dr. Economy.

DR. ECONOMY: No, I think, yes, there are many different studies that point to costs and benefits, and perhaps the real issue here is that we need to step back and do a truly excellent and comprehensive study of what we expect the real cost and benefits to be sector by sector to understand because I think Congressman Wessel started to point out some of the weaknesses. I think Peterson Institute has primarily focused on the strengths.

COMMISSIONER FIEDLER: He hasn't been elected dog catcher.

[Laughter.]

HEARING CO-CHAIR TALENT: I'm afraid you just demoted him, Dr. Economy.

DR. ECONOMY: Sorry. Sorry about that. Sorry.

[Laughter.]

DR. ECONOMY: Commissioner. I live in New York, you know, these distinctions. Anyway, so I think, I think maybe that there's a point here where we actually really need in the next several months, you know, before the new administration comes to power, to take stock of what exactly we can expect from the TPP.

I agree, credibility is a second order issue. It should be; right? The primary point of this trade agreement should be that it advances U.S. economic interests overall, again recognizing that there are winners and losers in this process. But the credibility is an important issue.

And I'll just refer back to the point I made in my testimony, which is I do think we have an economic narrative that is very much undersold in the region in terms of the U.S. being a leading source of investment, a more significant source of investment than China, for example,

and an important trade partner as an export market, but China gets an enormous amount of credit for being the engine of economic growth in the region, right, and there's a constant narrative within the region that, yes, we recognize we share values with the United States. You know, you are our security. You know you take care of the security domain, but we can't defend China because it's the source of economic growth.

So there's a compelling reason for us to be a much stronger player economically in the region and have a much stronger narrative than we currently do.

CHAIRMAN SHEA: Thank you.

HEARING CO-CHAIR TALENT: Okay. We have time for Commissioner Fiedler to have the last word.

COMMISSIONER FIEDLER: I'm going to leave TPP alone. The Anbang acquisitions of Starwood of late have been amusing to me on a number of different levels, but I mean the sort of Chinese tend to overpay for everything. Now, they've driven Marriott to probably overpay. But it raises interesting issues of opaqueness, where the money is coming from, the relationship of so-called private companies with government, and sources of funding, and then leads me to the uncomfortable place of the continued support and, in my view, U.S. complicity certainly in the business community with the operation of state enterprises in China.

Anybody share any of my concerns? Elizabeth.

DR. ECONOMY: Yes. I share your concerns. I am concerned about state-owned enterprise investment in the United States. I'm concerned about private investment that masks state-owned enterprise or Chinese government investment in the United States. I think CFIUS is going to have to become a very much more robust institution, transparent but robust, in order to accommodate what is likely to be, barring a much more significant slowdown in the Chinese economy, a ramped-up effort in Chinese investment into the United States, particularly as Chinese assets are not looking so good. I think there is going to be more and more outward bound investment.

So hotels are bad enough. Even worse are, you know, aviation interests that access then other kinds of defense-oriented technologies, and we're not even aware of what's going on. So I think I am quite concerned. Since it wasn't really a question, I second your concern.

COMMISSIONER FIEDLER: Yeah. Well, it is a question because all I was doing was laying out this phenomenon that continues to exist and that arguably we support based upon a form of greed frankly. There's money there; we want it. So we'll deal with them.

DR. BAKER: I'd just raise, not to distract from your point here, but I think there is a larger question that we have a lot. We see a growing amount of secrecy in corporate America, the delisting of companies, private, the growth of private equity. I think that is a more general problem. Obviously it feeds into this, but that's just being part of a larger story that private equity could shield lots of things that we may not want shielded.

MR. GOODMAN: I do think there are some real issues about SOE investment in the U.S. that need to be examined. I'm not sure that CFIUS is capable of doing that or the right place to do it, but I think that it is something that in the U.S. interests we should be looking at. I mean as for buying hotels, again, I share your amusement, having started as a Japan watcher in the 1980s and seeing how much money they wasted buying trophy assets and losing hundreds of billions of dollars without exaggeration--

COMMISSIONER FIEDLER: Pebble Beach.

MR. GOODMAN: --from those investments. Let Anbang, you know, lose all

that money. But I do think there are more serious questions about where this money is coming from, and we ought to be looking at that carefully.

COMMISSIONER FIEDLER: Thank you very much.

HEARING CO-CHAIR TALENT: All right. I see our time has expired for this panel. I do want to thank the witnesses again--really outstanding presentation--and for your responsiveness to the questions.

PANEL III INTRODUCTION BY VICE CHAIRMAN CAROLYN BARTHOLOMEW

VICE CHAIRMAN BARTHOLOMEW: All right. We'll go ahead and get started again. Once again, thanks to all of our witnesses who take the time to share their expertise with us. One of the things I always love about our hearings is that we interact so much and then see our panelists interact with each other, which is a great thing.

So for our final panel of the day, we will explore how China and other regional countries view and have responded to the U.S. rebalance to Asia, how the strategy has affected U.S. relations with China, and with our regional allies and partners, and how U.S. policy under the rebalance strategy can best address these key dynamics going forward.

First we'll hear from Dr. David Lampton. Dr. Lampton is Hyman Professor and Director of China Studies at Johns Hopkins School of Advanced International Studies, where he also heads SAIS-China, the school's overall presence in greater China.

Dr. Lampton is Chairman of the Asia Foundation and was formerly President of the National Committee on U.S.-China Relations. He is the author of several books and numerous published articles on China's political system and U.S.-China relations. His most recent book, *Following the Leader: Ruling China from Deng Xiaoping to Xi Jinping*, was published in 2014, which would be interesting to hear an addendum to that, given things that have unfolded over the course of the past year or so.

Next, we have Walter Lohman. Mr. Lohman is the Director of the Asian Studies Center at The Heritage Foundation and is also currently an adjunct professor at Georgetown University where he leads a graduate seminars on American foreign policy interests in Southeast Asia and Congress' role in Asia Policy.

Mr. Lohman previously served as Senior Vice President and Executive Director of the U.S.-ASEAN Business Council where he led multiple business delegations to Southeast Asia and regularly interacted with leading regional officials and business leaders. He also previously served as a foreign policy aide to two U.S. senators.

Finally, we have Dr. Sheila Smith, the Senior Fellow for Japan Studies at the Council on Foreign Relations. Her research focuses on how geostrategic change in Asia is shaping Japan's strategic choices. She is the author of *Intimate Rivals: Japanese Domestic Politics and a Rising China and Japan's New Politics in the U.S.-Japan Alliance*.

She previously studied at the East-West Center where she directed a multinational research team and a cross-national study of the domestic politics of the U.S. military presence in Japan, South Korea, and the Philippines. She also teaches as an adjunct professor at the Asia Studies Department of Georgetown University.

As I mentioned with our introductions to our first panelists, our witnesses have very long and distinguished resumes and biographies, and we can provide more information. But we can't spend our entire time talking about all the wonderful things you have all done.

So as we move forward, please keep your remarks to seven minutes, and we'll begin with you, Dr. Lampton.

**OPENING STATEMENT OF DR. DAVID LAMPTON
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HOPKINS SCHOOL OF ADVANCED INTERNATIONAL STUDIES**

DR. LAMPTON: Thank you. Thank you, Madam Chairman, and I want to thank the Co-Chairpersons and all the Commissioners for giving me an opportunity to speak with you and share my views. I'm also glad to be here with my two distinguished colleagues.

Today, in Asia, the United States faces important developments that require some adjustments to the Asia rebalance and the way in which we engage with China. We do not want to throw out the baby of engagement successes with the bathwater of all the current problems.

Core concerns of today's hearing include: the increasing tension and prospects for miscalculation in the South China Sea [In case you haven't had a chance to see it, the top half of the front page of today's New York Times is precisely devoted to this issue. It's a quite interesting article]. There is mounting Chinese power accompanied by riskier Chinese maritime policy. There's the increasing use of a "deterrence" vocabulary by both Washington and Beijing. We have a Korean Peninsula with nuclear weapons and rising numbers of missiles. There's growing nationalism throughout the region; nascent regional arms spirals and territorial competition. I was just in Timor Leste in January. Three PLA vessels pulled into Timor Leste, a small island nation of 1.2 million people. There is a limited realignment occurring between Russia and China. There's worrying Sino-Japanese mistrust and tension. There are large capital flows from the PRC and slowing Chinese economic growth affecting the PRC's trade and finance partners, as well as China's own internal stability.

China is not the cause of all these phenomena, but it is germane to all of these phenomena.

The U.S. interest lies in an Asia-Pacific in which the region has an open economic architecture and in which no single Eurasian or other power is able to exercise hegemonic political, military or economic dominance. America's own strength combined with that of like-minded states in the region needs to be sufficient to prevent America from becoming an outsider to the regime's economic or security institutions.

Let me summarily tick off the major points in my longer written testimony. First, if I were in Beijing now, I would be considering the current circumstance in which so many states on the PRC's periphery are looking to Washington and to others for security reassurance as undesirable and ultimately contrary to the PRC's own interests.

Having the strategic alignment of Japan, the United States, Australia and others emerging, when China is only able to move closer to Moscow, and maybe Islamabad and Pyongyang if you throw those in, is not strategically in China's interests. Confidence in the United States strategic position is justified. I think we're in a pretty strong position.

Second, the single biggest thing Beijing could do to improve its own circumstance is to reassure its neighbors, to settle or shelve its disputes along its land borders or its maritime borders as it did along its land borders in the not so distant past. Absent this approach, Beijing is pursuing a self-limiting policy. This is really almost inexplicable to me--China's driving its periphery into U.S. arms.

As for the U.S. attitude, Washington should encourage the parties to the maritime disputes, whether through bilateral or multilateral means, to adopt reasonable compromises.

Third, we should seek to maintain domestic U.S. support for U.S.-China relations when dealing with a stronger China by tenaciously seeking more reciprocity in bilateral

arrangements, whether it be on the trade front through a bilateral investment treaty, the treatment of American and foreign journalists in China, or the environment for foreign direct investment in both of our countries.

I don't think we've done nearly enough to seek reciprocity. One hand washes the other would sort of be my take on this.

Next, we should resist becoming immobilized by Beijing's overt and implied warnings that link one issue to another, and we should more effectively link our behavior to China's. A good example is the recent interaction regarding sanctions on North Korea. Beijing became more motivated to be helpful when it understood that its failure to act was driving Seoul and Washington to move ahead with missile defenses for South Korea.

Next, we should anchor the U.S. position in international law, ratify the Convention of the Law of the Sea. This would be an enormous credibility booster for the United States. The U.S. should be supportive of whatever rulings come out of the Permanent Court of Arbitration in The Hague.

Next, we should seek to build economic and security institutions that include both China and the United States, rather than parallel systems as we've seen Beijing and Washington do. Not taking a more proactive and positive view of the Asia Infrastructure Investment Bank initially was a mistake in my view. Don't keep saying to China that it should not write the rules of the 21st century trade system. Of course, China has to play a role. It's the first or second-largest trading nation in the world. It should play a role, not the role, and so we should not act as though we're trying to freeze China out.

Next, the U.S. should bring its internal and external priorities into greater harmony. Prioritize. Washington's current practice of not choosing among external challenges has the problem of simultaneously energizing all our challengers. It drives Russia and China closer. It creates doubt that the United States has the capacity to handle all these problems simultaneously.

This difficulty of no priorities is compounded by the seeming inability of Washington to focus on our own bases of comprehensive national power--our domestic economy, our financial and ecological sustainability, our infrastructure, our human resources.

And, finally, we and like-minded countries need to credibly affirm that Beijing will not be able to gain advantage through its incremental strategy in the South China Sea. The U.S. weeks-long public agonizing debate in October 2015 over whether or not the U.S. should cross the 12-nautical mile "limit," quote, at Subi Reef is the kind of irresoluteness that we should avoid.

Concluding, for me, the ultimate question is how do we secure the many common interests that we have with China as we provide incentives for Beijing to avoid destabilizing activities? And I would say the concept of what I would call reciprocal engagement, that is arguing more for reciprocity, and I'm sometimes amazed that the U.S. media doesn't push harder to tie access of the Chinese media to the U.S. to our access to China, would be just one example. We need the concept of reciprocal engagement and working with like-minded states when Beijing pushes too hard.

Thank you.

**PREPARED STATEMENT OF DR. DAVID LAMPTON
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March 31, 2016

David M. Lampton

Professor and Director of China Studies, Johns Hopkins—SAIS
Testimony before the U.S.-China Economic and Security Review Commission
“China and the U.S. Rebalance to Asia”

“Rethinking How America Engages China”

I thank the Commissioners Co-Chairing this Hearing for the invitation to share my thoughts with the Commission.

Perspective

That today’s Hearing is convened the same day that Chinese President Xi Jinping and other foreign dignitaries are in Washington for the opening of the Nuclear Security Summit is indicative of a fundamental reality in U.S.-China relations. At any given moment Beijing and Washington have a great diversity of issues at stake of consequence to themselves, the region, and the world. Some issues and interests bring Washington and Beijing together--others separate us. Each of our countries has to weigh the degree to which it will let disagreement in one area narrow the possibilities for cooperation in others. As we consider the Asia “rebalance” we need to keep this in mind.

“Constructive engagement” with the People’s Republic of China (PRC) has had a shelf life of nearly four decades. Such policy longevity and the accompanying positive change in Asia suggest that engagement has, up to recent times, been remarkably successful. Considering that two major wars (Korea and Vietnam) occurred in the period preceding U.S.-PRC normalization, and none thereafter, and that the region has modernized very substantially in the environment fostered, in part, by engagement, the success of past policy is considerable. While positive change has occurred for many reasons, the central fact is that regional welfare levels have grown along with increasing urbanization throughout the region. Middle classes have developed, driving both economic growth and political change to various degrees in various places. This progress, along with its predictable effect of creating stronger regional actors, sets the stage for today’s Hearing. Our challenge is to adapt to the changes that past success has wrought and respond to some of the accompanying problems, particularly changes in PRC behavior. Our goal should be to foster balance, stability, and rules-based behavior in the region, aspiring to create the basis for another four decades of stability and progress, progress that includes China.

Overview and Recommendations

I recall an insightful phrase that Dr. Thomas Fingar, former deputy director of national intelligence for analysis, used in his recent edited volume entitled The New Great Game: China

and South and Central Asia in the Era of Reform. In assessing China's decision calculus in dealing with other countries Fingar argues that Beijing's core consideration is: "What they can do *to* China and what they can do *for* China" (p. 6). We should keep this wisdom in mind as we move into a new era in U.S.-China relations.

Among today's changed circumstances in Asia and U.S.-China relations are: Growing Sino-American friction along several dimensions even as positive cooperation proceeds along other important fronts. Particularly worrisome is the increasing tension and prospect for miscalculation in the South China Sea; Mounting Chinese power accompanied by riskier Chinese maritime policy; the increasing use of a "deterrence" vocabulary by both Washington and Beijing; a Korean Peninsula with nuclear weapons and growing numbers of missiles; rising nationalism throughout the region; nascent regional arms spirals and territorial competition; a limited (and perhaps not durable) realignment between Russia and China; worrying Sino-Japanese mistrust and tension; and, mounting capital flows from the PRC (flight and investment funds) and slowing Chinese economic growth affecting the PRC's trade and finance partners, as well as China's own internal stability.

It is apparent that in the late-Hu Jintao era, and in more pronounced fashion under China's current leader Xi Jinping, Beijing has embarked on internal policies of tightening, trying to tame the economic and political interests that have arisen in the course of the last four decades' social and economic development. The trends toward more collective leadership and related leadership norms established during the preceding decades of the reform era seem to be in retreat, at least for now. There has been movement backward toward the old political playbook in China with a more intrusive Party and its attendant security and propaganda structures. Stability on the Mainland is not to be taken for granted, and churning in China will roil the waters throughout Asia and the global economic system. In its foreign policy, Beijing is driving many neighbors to seek shelter under the U.S. security umbrella and promoting closer security coordination among many of the region's powers. The more China pursues these unsettling domestic and foreign policy lines, the more it is self-limiting and the more America and others in the region will respond, indeed are responding.

This catalogue of concerns does not even include old stand-by challenges such as the Taiwan and Hong Kong identity problems. The above challenges, and the need to keep the support of the American people for constructive China policy, have reached the point of requiring adjustments in U.S. policy and attitudes. The "Asia Rebalance" (or pivot/rebalance) was an initial effort in this regard, but this policy needs to be broadened and modified. Appropriate adjustments could go under the broad rubric of "*reciprocal engagement*." Key elements of reciprocal engagement include:

- Adopting a broad frame of mind in the United States that China gradually has moved from being a "developing country," arguably entitled to special consideration (as was extended to some extent in the World Trade Organization accession negotiations), to the status of a "great power" (*da guo* in Beijing's own current lexicon) requiring far more reciprocity on Beijing's part. Maintaining domestic U.S. support for U.S.-China relations when dealing with a stronger China means tenaciously seeking more *reciprocity* in

- bilateral arrangements, whether it be (for example) on the trade front, the treatment of journalists, or the environment for foreign direct investment (FDI) in both countries;
- Resisting becoming immobilized by Beijing's overt and implied warnings that link one issue to another and more effectively linking our behavior to China's. A good example is the recent interaction regarding sanctions on North Korea. Beijing became more motivated to be helpful when it understood that its failure to act was driving Seoul and Washington to move ahead with missile defenses in South Korea. Part of China becoming a great power is for it to acknowledge that its failure to act has consequences;
 - Anchoring the U.S. position in international law. In this respect, ratifying the UN Convention on the Law of the Sea would be an enormous credibility builder for America. With respect to the PRC's incremental strategy of creating new geographic features on tidal elevations and rocks in the South China Sea, the U.S. should continue with its posture of not allowing China's, or anyone else's, activities to change the customary behavior in the area. Washington should take measures that make clear that China will gain no military or commercial advantage by occupying vulnerable rocks;
 - Seeking to build economic and security institutions that include both China and the United States, rather than parallel systems as we have seen both Washington and Beijing do. Washington should exert itself to make room for China in the international system, and conversely, Beijing ought not place emphasis on building regional institutions that do not allow for U.S. participation;
 - And finally, bringing U.S. internal and external priorities into greater harmony and prioritizing among them is essential. Washington's current policy of not choosing among external challenges (e.g., Russia, ISIS, China, and wars elsewhere in Central Asia) has the problem of simultaneously energizing all U.S. challengers, driving Russia and China closer to one another, and creating doubt in the minds of many in the global and regional systems that the United States has the capacity to handle all the problems simultaneously. This difficulty is compounded by the seeming inability of Washington to focus on its own genuine bases of national power—the domestic economy, financial and ecological sustainability, infrastructure, and human resources. The best way to be effective abroad is to be effective at home. Defining China as a co-equal problem with many other national challenges renders Washington unable to focus and runs the danger of draining resources from the most important tasks. The failure to distinguish among challenges also overlooks the many areas of compatibility between Chinese and American interests. The PRC need not be America's biggest problem, and vice versa.

The U.S. (“Pivot”) Rebalance to Asia

The “pivot” policy articulated in late-2011, and re-branded and adjusted as the “rebalance” subsequently, was not artfully rolled out of Washington. The military and security sound tracks of the policy drowned-out the economic and diplomatic sound tracks. China immediately, and indelibly, saw this as part of a neo-containment strategy, with PRC hawks using this perception to enhance their own organizational interests and political positions. Moreover, U.S. policy never has fully overcome the suspicion throughout the region that entanglements elsewhere sap America's ability to deliver on implied promises of reallocating resources (economic, military, and diplomatic attention) toward Asia, though the Obama Administration actually has made some progress in this direction. Complicating matters, regional states seek to enhance economic

benefits with China even as they seek refuge in the American security embrace. They are sensitive to what they see as the twin dangers of U.S. provocation of China, on the one hand, and insufficient attention by Washington on the other. They hedge their bets through a combination of strengthening themselves, keeping America in the game, and building positive relations where they can with Beijing. For its part, Washington needs to be wary of getting dragged into conflicts in which U.S. *friends* act imprudently.

Although unwelcome changes in Beijing's internal and external behavior began to occur in the late-Hu Jintao period (2009-2012), the transition to the Xi Jinping era has accelerated less reassuring internal and external directions in China's policy—domestic tightening and external muscularity. All this has produced a pronounced regional (and bilateral U.S.-China) action-reaction dynamic. This dynamic is manifest in growing military procurement and system upgrades in many states, rising military budgets as in Australia, competition for new power projection sites throughout the region (e.g., India and Andaman Island, the U.S. in the Philippines, Australia, and Guam, and China in the South China Sea [Paracel and Spratly islands]) as well as contemplating base-like arrangements elsewhere. As Washington, Tokyo, New Delhi, Canberra, and others engage in joint military exercises, so Beijing increases its military exercises with Moscow and others in Central Asia. Although U.S.-China military exchanges and activities have grown during the Obama Administration, the overall security dynamic nonetheless is negative.

U.S. Interests and Appropriate American Responses

The Asia Rebalance seeks to promote fundamental U.S. interests that have been the linchpin of American policy and thinking about China and Asia for well over a hundred years. That is, the U.S. interest lies in an Asia-Pacific in which the region has an open economic architecture and in which no single Eurasian or outside power is able to exercise hegemonic (political, military, and/or economic) dominance. *The United States does not need (and should not aspire to) absolute primacy, defined as being able to unilaterally resolve all problems to its satisfaction across all security, economic, and diplomatic issues, under all possible configurations of opponents.* Instead, America's own strength, combined with that of like-minded states in the region, needs to be sufficient to prevent America from becoming an outsider to the region's economic and security architectures. The undiluted quest for primacy as defined above is unachievable and it is unnecessary, wasteful, and ultimately self-defeating. The preferred path should be for China, the United States, Japan, and others to build a Pacific Community—to hold out the aspiration for a structure in which there is no odd man out. *Absent movement toward such a community, America needs to assure that the preponderance of economic and security power is in the coalition of which it is a preponderant part.*

It is always useful in a negotiation to realize that you (in this case the United States) do not have the biggest problem. Confidence should undergird the American position. We don't need to be pugnacious—rather, be confident. If I were in Beijing now I would be considering the current circumstance in which so many states on the PRC's periphery are looking to Washington and others for security reassurance as undesirable and ultimately contrary to the Beijing's own interests. It is hard to see how having a solidifying strategic alignment of Japan, the United States, Australia, and others emerging, when China is only able to move closer to Moscow (Islamabad and Pyongyang), is a strategically advantageous position for the PRC.

The best way for China to enhance its own security and improve Sino-American ties is to reassure its neighbors and focus on the economic upsides of regional growth for all. In this regard, the idea of transportation “connectivity” embedded in China’s regional infrastructure initiatives has the germ of a good idea, though each particular component needs to be considered on its own merits. Washington should avoid a knee-jerk negative reaction against this and assess opportunities for participation as they may arise. With slowing growth, mounting domestic political and social problems, and the increasing security anxiety of its neighbors, China’s interests lie in getting back on the path of shared growth and focusing on its own domestic necessities. The single biggest thing Beijing could do to improve its own circumstance is to reassure its neighbors—to settle or shelve its current maritime issues in the same flexible fashion it addressed disputes along its land borders in the not so distant past. As for the U.S. attitude, Washington should encourage the parties, whether bilaterally or multilaterally, to adopt reasonable compromises.

How Well Has the “Rebalance” Been Implemented?

The roll out of the “Pivot” in late 2011 was less than artful, though there have been some needed adjustments since, one being a more pronounced emphasis on the economic component. The presidential-level Sino-American dialogue and augmented military-to-military exchanges have been appropriate and welcome. These positives notwithstanding, however, it has been hard to dissuade Beijing from its initial “containment” perspective on U.S. policy given the 2011 presidential address to the Australian Parliament about communism’s political future (November 2011); the initial focus on rotating U.S. troops through Darwin, Australia; then Secretary of State Clinton’s remarks about the West Philippine Sea in Manila Harbor (November 2011); and pushing a Trans-Pacific Partnership (TPP) that included Vietnam, but not the region’s biggest trader, China. Thereafter, there have been what I consider to have been a string of counter-productive moves and statements, including the ill-starred effort to impede the creation of the Asia Infrastructure Investment Bank (AIIB) and repeated presidential statements to the effect that we cannot allow China to be writing 21st century trade rules—a statement that while true at one level actually suggests that Washington’s preference may be that Beijing play no role. In short, the “pivot/rebalance” was and is an appropriate impulse in terms of augmenting U.S. comprehensive involvement in Asia, but our own rhetoric and behavior has made the path bumpier than need be.

Another key issue in the implementation of the “pivot/rebalance” has been the underlying assumption that as the United States disengaged from Central Asia and the Middle East in terms of active conflict, this would permit some relative reallocation of military (and presumably other) resources toward Asia. This rebalancing often has been expressed as shifting the allocation of naval assets from 60 percent elsewhere to 60 percent in the Asian region (Defense Secretary Panetta, June 2012). Beyond the fact that the Central Asia and Middle East conflicts have been more tenacious than initially anticipated (and we simultaneously have become involved in new areas of conflict such as Libya and Syria), there also is the competition represented by long-deferred American domestic investments, among which we can include: infrastructure, education, retirement for an aging population, health care, fiscal sustainability, etc. As all these diverse competing needs weigh in the overall balance of decision, this ratio of 60:40 can seem like a shell game—a bigger percentage of a smaller pie for Asia. This arithmetic formulation also immediately sets up a zero-sum mentality with our partners everywhere else in the world who

see our resources devoted to them intimately linked to the augmentation presumably occurring toward Asia. Friends and competitors in Asia and around the world have to ask themselves, “Will the U.S. really have more actual capability?” “If Asia gets more, will we get less?” I am inclined to think that talking less, and doing more is the right approach for Washington.

In short, the “pivot/rebalance” has contributed to Chinese anxiety, stoked negative reactions from Beijing, and not entirely reassured the region (and others elsewhere) that the U.S. will allocate the necessary resources. There is also the problem of threading the needle of reassuring America’s friends by our presence while alleviating the anxiety that we will be ham-handed and unnecessarily inflame Beijing. Beyond this, there is the broader uncertainty concerning where in the hierarchy of strategic priorities China falls for Washington. Asserting, as the Department of Defense does, that America cannot afford to choose among global challenges (Russia, China, ISIS, and other Middle Eastern and Central Asian conflicts) does not disperse the conceptual fog or secure the necessary resources. We need to ask: “Is China really among the big two strategic problems America faces at this moment and in the mid-term?” “Does it need to be?” By the way, China should be asking itself the same questions about the United States with even greater urgency.

The Response to the “Rebalance” Among Other Countries in the Region

Regional responses to the pivot/rebalance, and to China’s maritime assertiveness, have varied, with non-maritime states (e.g., Thailand and Laos, seemingly more relaxed). Maritime states such as Singapore, Australia, the Philippines, Japan, Vietnam, Malaysia, and to some extent Indonesia are more directly concerned by, and worried about, Beijing’s maritime activities, and pay great attention to the American response. States with conflicting territorial claims with Beijing are more concerned still. Then there is the issue of countries allied with the United States. Japan, the Philippines, and Australia clearly align with Washington—with Canberra recently adopting a robust procurement and budget plan. Japan is expanding its security footprint, role, and resources steadily, but commitment along these dimensions does not translate directly into Tokyo’s ability to solve intractable bilateral U.S.-Japan problems like base relocation on Okinawa. In a similar vein, Tokyo, I understand, did not listen to U.S. advice not to “nationalize” the Senkaku/Diaoyu Islands in the fall of 2012, a move that has precipitated Sino-Japanese tension. The Philippines, the country that asked the United States to leave its bases in 1992, now seemingly welcomes a new relationship nearly a quarter century later.

Each country in Asia is its own story, but generally China is unhappy with the directions in which Myanmar (Burma) has moved. India, for its own reasons and in its own way, is also taking progressively more wary account of China’s maritime policies and actions. The Republic of Korea is focused principally on North Korea, but becomes progressively more receptive to missile defense deployment in cooperation with Washington the more threatening North Korea becomes. China is paying a progressively larger price for North Korean provocations and the recent UN sanctions placed on North Korea with Beijing’s support indicate that PRC patience with Pyongyang is wearing thin. Frankly, what we are seeing in terms of regional reaction is explained more by PRC behavior (and the behavior of others such as North Korea) than some imputed powerful pull of Washington’s rebalance policy. That is why at every opportunity I suggest to Chinese colleagues: “If you want to change the situation, reassure your neighbors by getting the focus more clearly back on your own internal reform, be flexible on maritime issues

with your smaller neighbors, and foster constructive economic interaction with your periphery (as 'One Belt, One Road' broadly aims to do). The path to a better relationship with Washington is through the capitals of your neighboring states." One cannot help thinking of the old saw: "When a challenger is committing suicide, don't take the gun out of his hand."

The appropriate U.S. response is to hold out the vision of inclusive economic and security structures in Asia, work with Beijing on issues on which we can constructively collaborate, and make it clear that U.S. actions in the region will be grounded in international law and the collective interests of almost everyone in the region. We and like-minded countries need to credibly affirm that Beijing will not be able to gain advantage through its incremental strategy in the South China Sea. The U.S. weeks-long, public, agonizing debate in October 2015 over whether or not the U.S. should cross the 12 nautical mile "limit" at Subi Reef is the kind of irresoluteness that should be avoided. U.S. policy makers should have confidence that Beijing has put itself on the wrong side of these developments. Close alignment with Russia offers little help to Beijing when one considers either the PRC's internal challenges or taming its vast periphery. U.S. statements and actions should be anchored in a clear policy of welcoming China into developing regional economic and security institutions and regional and global rule writing. We should avoid unfortunate events like the imbroglio over the AIIB. This posture would be welcome in the region. As one senior former South Korean official put it to me in late-2014, "Don't [you, the U.S.] force us to choose between our interests with China and our interests with you."

What Effects Has the Rebalance Had on PRC Behavior?

It is difficult to judge how China's behavior may have been affected by the "rebalance" for many reasons. To start, many considerations drive Chinese foreign policy behavior, so picking a single factor is risky and the predominant causes of behavior in one instance may be quite different in another. Second, Chinese behavior is itself diverse, varying by issue and locality, even at the same time. And finally, it is hard to tell when Beijing's actions are a result of domestic dynamics or a response to the behavior of others. Chinese officials usually assert that China responds to others rather than initiates--that its behavior is defensive and reactive in character. Nonetheless, I believe that the pivot/rebalance has contributed to at least four phenomena with some consequences being more positive than others:

1) The pivot/rebalance has set off debates in China. There is a vigorous debate occurring in PRC foreign policy circles about whether or not China should be confronting the United States in East and Southeast Asia, or deflecting problems there while developing opportunities in less congested areas such as Central Asia, Africa, and elsewhere. There also is debate internally about whether or not Beijing has prematurely abandoned its policy of "hide and bide," keeping a low profile as the country modernizes, with some PRC analysts feeling that China's activism is premature and ill-advised given competing domestic needs, national capabilities, and the predictable anxieties of neighbors. There also is debate over how potent a strategic asset Russia may be. Finally, there also is debate in China about the underlying strength of the United States and how to assess its future comprehensive national power. In 2008-2009, the sense of Chinese power was ascendant in the PRC, given America's economic problems and China's relatively strong economic performance. With recovery in the United States and growing economic and social problems in China, there seems to be a greater appreciation for American power and

resilience, though Beijing still anticipates a multi-polar future, with Washington possessing relatively less leverage over time as others grow.

2) Alarm bells went off in Beijing soon after the pivot/rebalance was initiated. An initial move Xi Jinping made upon his ascension to power in 2012-2013 was to convene a number of rather unprecedented foreign policy-related meetings and to establish a new National Security Commission (announced in November 2013 and established the following January). These meetings and moves were aimed at a number of problems, including the need to more adequately coordinate Chinese foreign and security policy and the felt need to deal with what Xi viewed as the connection between foreign external pressure and internal subversion in China (here the Color Revolutions and Arab Spring, along with soon-to-be political mass movements in Hong Kong and Taiwan in 2014, played their role in heightening Beijing's anxieties.) The pivot/rebalance contributed to the Chinese tendency to see the "black hand" of the United States at work in stirring up internal challenges in Hong Kong, for instance.

These conferences and initiatives, however, also gave rise to some positive diplomatic efforts by the PRC vis a vis Vietnam, Japan, the Philippines, and India, among others. Nonetheless, there remains a contradiction between the hard and soft power messages Beijing is sending its neighbors, with its neighbors taking more seriously the hard power actions.

3) Xi Jinping initiated a drive to emphasize economic connectivity on the seas and by land (although this policy had earlier antecedents such as the Pan Asia Railway idea of the 1990s and early 2000s). "One Belt, One Road," the AIIB, and the Silk Road Fund, among other similar initiatives, were/are an effort to use economics to reassure and to bind others to China and to offset the perceived isolating thrust of U.S. policy. To be clear, however, China's "Belt and Road" initiative has many mutually reinforcing logics--overcoming the perceived isolating aim of the rebalance is only one of them.

4) If one asks knowledgeable Chinese what effects on the PRC they think the "Pivot/Rebalance" has had, one hears (and I am not endorsing these views) that the U.S. policy has emboldened Vietnam and the Philippines to be more assertive (with the presumed protection of Washington) and enabled Japan to enlarge its regional military role and defense posture in ways that alarm Beijing and Chinese citizens generally. Liberals in China would go on to say that this policy has put another arrow in the quiver of arguments of more repressive and assertive elements in the PRC elite for more muscular internal and external policies.

The ultimate question is: Are the restraining and positive effects of the rebalance greater than its provocative and negative effects? I believe the positives could outweigh the negatives—and inaction might be the costliest route of all. History and interest require the United States to play a large, indeed growing, role in Asia. However, we must ask ourselves: How can we best, credibly play that role? Do we need regional primacy and what does that mean? And, how do we secure the many common interests we have with China as we provide incentives for Beijing to avoid destabilizing actions? The concept of reciprocal *engagement* articulated at the outset of this Testimony may be a place to start.

**OPENING STATEMENT OF MR. WALTER LOHMAN
DIRECTOR, ASIAN STUDIES CENTER, THE HERITAGE FOUNDATION**

MR. LOHMAN: Thank you. Let me start by thanking the Commission for having me here again today. I'm always happy to come over and talk to you all about China and the region more broadly.

Before I start, a sort of standard caveat: nothing I express in my testimony today should be construed as representing official position of The Heritage Foundation. These are my own views.

For many decades now, American policy in the Asia-Pacific has resolved around two sets of interests: regional peace and security; and free trade and unfettered flow of commerce.

In his launch of the rebalance in 2011, President Obama outlined a strategy to promote these interests that could easily have been spoken by his predecessor. The strategy involved maintaining a "strong military presence," in the region; the "unique ability to project power and deter threats to peace," and keeping treaty commitments to our allies.

On economics, President Obama cited a strategic interest in "open and transparent economies," an "open international economic system," and "trade that is free and fair," again, things that could have easily been spoken by President Bush.

With regard to diplomacy, Secretary Clinton also, in 2011, called for a "forward deployed diplomacy" that among other things would deepen our working relationships with emerging powers and to "engage with multilateral institutions."

I would suggest that the next administration maintain the same broad strategic touchpoints. I would also suggest that it maintain several of the tactical changes that President Obama made in the course of implementing the strategy.

On the military side, a new administration should follow through on the most consequential pieces of the rebalance, to include the Marine and Air Force deployments through northern Australia and to build out the arrangements for new deployments to the Philippines, arrangements for which were just finalized a couple weeks ago.

A new administration should also continue to expand U.S.-Japan military and strategic cooperation and prod the South Koreans to think strategically beyond the Peninsula.

As I point out in my written testimony, for all the attention that the Obama administration has brought to Southeast Asia, actually our alliances in Northeast Asia are so big and encompassing that little changes in those alliances go a much longer way than small deployments to Southeast Asia.

On the economic side, the next president will probably have to bring to final disposition the Trans-Pacific Partnership. This is a complex political issue with many moving parts, and I don't want to get into all of that, but just to point out the importance of economy to the U.S. role in the region. We're talking a lot about military and diplomacy here, but the Asia-Pacific is mostly about trade and economics.

If the U.S. is not involved in the story at an appropriate level, all of its activity on the political security side will over time come to be seen as that of an outsider, an interloper. As a result, the U.S. will underserve its interests across the board in the region.

And with regard to diplomacy, the next president will do very well to maintain and build on the Obama administration's embrace of ASEAN-centric architecture.

One thing I try to make clear in my written testimony is the enduring value of

America's hubs-and-spokes network of allies and partners in the region. Engaging ASEAN is a very important context for American policy. The most critical tasks, however, will continue to be done through our bilateral relationships. For all the good work it has done on the bilateral level, the Obama administration has occasionally threatened to lose perspective on this.

Similarly, when the next president looks for new partners in the region, it should prioritize those places where the U.S. already enjoys cooperative legal and operational frameworks, places like Japan, South Korea, Australia, Singapore and the Philippines.

And I'll close with just a word about the regional response to the rebalance, and hopefully that's something we can get into more in the discussion. My testimony sets the above-referenced partners along a continuum with Japan, Australia and South Korea as the most useful supporters/facilitators of the American rebalance, followed by Singapore and then the Philippines.

I would put others in the region, like Malaysia, Vietnam, and Indonesia, at the other end of the spectrum. I would call them hedgers. All supporters/facilitators and hedgers are very sensitive to signals from Washington. Strong signals, for example, healthy defense budgets, statements of support for alliances, FONOPS, these things reassure countries in the region and encourage them to support the U.S. presence.

Signs of weakness, the ill-fated deal that the U.S. made with China over Scarborough Shoal in 2012, for instance, have the opposite impact on the confidence we instill in the region and the amount of support we are likely to get for American presence long after the rebalance has served its purpose.

So with that, thank you for having me here to testify. I look forward to the questions and answers.

**PREPARED STATEMENT OF MR. WALTER LOHMAN
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After the Rebalance to Asia

U.S.–China Economic and Security Review Commission

March 31, 2016

Walter Lohman
Director, Asian Studies Center
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My name is Walter Lohman. I am Director of the Asian Studies Center at The Heritage Foundation. The views I express in this testimony are my own and should not be construed as representing any official position of The Heritage Foundation.

For five years now, Washington has been debating the value of the Obama Administration’s rebalance to Asia. Questions have arisen over how it was formulated and rolled out, how well it is resourced, whether it too heavily weighted toward military matters, and whether the new attention is sufficiently distributed throughout the region. Experts and stakeholders in the policy have tried to sort out and explain China’s role, Taiwan’s role, the role of the Association of Southeast Asian Nations (ASEAN) and other regional organizations. Washington has spent an inordinate amount of time on the implications of the terminology itself, “pivot” or “rebalance.” In short, the “rebalance” has been very carefully considered from virtually every angle. Now, in the midst of a political season in which Americans are debating their nation’s role in the world, it is time to take stock and start looking beyond the rebalance to the time when a new Administration will take ownership of Asia policy.

It has been said before, often by veterans of the Bush Administration, that there was nothing new about the rebalance. This is essentially true. For many decades now, American policy has revolved around two sets of interests: (1) regional peace and security and (2) free trade and the unfettered flow of commerce. The threats to these interests have changed over time. Priority threats have included Soviet aggression, violent extremism, and alternative models to free-market liberalism. The nature of these threats is what has shaped the United States’ military posture in the region, its official economic engagement, and diplomacy. Today, the priority threats to American interests in the Western Pacific are bound up in the challenges presented by China’s rapid rise as a major, modern regional power. And strategy has developed accordingly.

Seen this way, the rebalance is not strategic innovation, but tactical adjustment. The President himself, in his 2011 launch of the rebalance, made explicit the connection between enduring interests and strategy, on the one hand, and tactics, on the other. Speaking to the Australian Parliament, President Obama outlined a strategy that could have easily been spoken by his predecessor. It involved maintaining a “strong military presence” in the region, preserving a “unique ability to project power and deter threats to peace,” and keeping treaty commitments to

allies. On the tactical side, he cited a modernization and broadening of America's defense posture across the Asia-Pacific, to include an enhanced presence in Southeast Asia. He also highlighted the need for a more flexible military posture, one made more sustainable "by helping allies and partners build their capacity, with more training and exercises." On economics, he cited strategic interest in "open and transparent" economies, an "open international economic system," and "trade that is free and fair." Tactically, President Obama referenced free trade agreements with Australia and South Korea and the Trans-Pacific Partnership (TPP).

With regard to diplomacy, the earliest comprehensive expression of Administration strategy came from Secretary of State Hillary Clinton in the lead up to President Obama's visit to Australia. In a piece entitled "America's Pacific Century" in *Foreign Policy*, she used the term "pivot" that would so bedevil Washington policy analysts. She also called for a "forward deployed diplomacy" that among other things would "deepen...our working relationships with emerging powers" and "engage with multilateral institutions." As with the military and economic elements, Secretary of State Clinton offered no strategic breakthroughs. The previous Administration had done similar things. But Secretary Clinton did point to what would become the Administration's most significant tactical shift—intensified engagement of ASEAN.

The Military Side of the Rebalance

The most visible part of the rebalance has been on the military side. There have been several important Obama-era initiatives on this account. Among them, the agreement with Australia to rotate Marines and Air Force through Northern Australia and the Enhanced Defense Cooperation Agreement (EDCA) with the Philippines, according to which the two sides have just settled on five bases which will be prioritized for upgrades and American rotations. There are other efforts which were initiated prior to President Obama's time in office, the continuance of which can fairly be attributed to his call for a posture that is flexible, sustainable, and modernized. These include, in fact, the biggest moving parts of the rebalance: the Guam/Okinawa force realignment and the realignment of American forces on the Korean Peninsula.

Much smaller moves, like the rotation of Littoral Combat Ships (LCS) and anti-submarine aircraft through Singapore and the deployment of additional Aegis destroyers to Japan and submarines to Guam are significant, but more a matter of routine force management—conceivable without the rebalance.

With broader respect to our military presence, the U.S. is very close to the goal of having 60 percent of its naval assets in the Pacific as first announced by former Secretary of Defense Leon Panetta in 2012. It already has 60 percent of Air Force assets and two-thirds of its Marine Corps there. These assets contribute to the wide range of exercises and training activities in the region, port calls, reconnaissance, and freedom of navigation exercises underway in the region at any given time. In 2011, PACOM put the number of multilateral and bilateral exercises at 172. For 2015, this number is likely lower. If so, it is worth the commission examining the significance of the decline. Whatever the number, it must be considered in the broader context of U.S. operations in the region. The U.S. just completed annual Cobra Gold exercises. RIMPAC 2016 is on target this year, as are the annual Malabar exercises among the U.S., Japan, and India

this year in the Philippines Sea. There are many others besides, including the CARAT series, Balikatan with the Philippines, and Talisman Saber with the Australians. We have multiple and expanding exercises with Japan. And given the close integration of U.S. and South Korean forces and immediacy of the threat they face, virtually every day is a joint exercise for the 28,500 Americans stationed there. Specific efforts like the massive Key Resolve and Foal Eagle exercises receive more than their usual share of attention when there is tension on the Peninsula. But they are ongoing and routine.

The U.S. presence in the Asia–Pacific is impossible without its many allies and partners. U.S.–ROK and U.S.–Japan cooperation is almost a given. These alliances are so big and capable that changes in them have exponential impact. Japan’s reinterpretation of its right to collective self-defense and new U.S.–Japan Defense Cooperation Guidelines are good examples. Japan’s 2014 relaxation of export restrictions is another. The latter may result in state-of-art Japanese submarines being built in Australia for service in the Australian navy—a development with major strategic significance. Even smaller adjustments to existing exercises, like recent expanded Japanese participation in joint amphibious exercises, receive an outsized degree of public attention. The extraordinary record of U.S.–Japan military cooperation means that when planners look to augment the U.S. presence in the region, discussing the prospect of basing a second American aircraft carrier in the Pacific, for instance, where is the most logical place for it to go? Japan. U.S.–Korea strategic cooperation has similar potential, but due to Korea’s existential preoccupation with North Korea, it remains thoroughly unfulfilled.

The more fundamental tactical shift of American security policy lies in what has been called the “rebalance inside the rebalance”—that is, the shift of American attention and resources south. Here the U.S. has also found willing partners, most prominent among them Singapore, the Philippines, and Australia. As with Japan, in each case, there are important long-term legal and operational contexts that have made the expansions possible. In fact, although good diplomacy often requires reference to cooperation with other partners in discussion of this move south, cooperation with Malaysia, Vietnam, Indonesia, and others is not nearly as extensive. This is not only for political or strategic reasons, but because the U.S. lacks legal and operational frameworks in these places necessary for rapid ramp up in activity.

Singapore is the perfect example of an enabling partner environment. The most important innovation in U.S.–Singapore relations is not new ship and aircraft deployments attributed to the rebalance. The U.S. Air Force and Navy have long operated out of Singaporean bases. The most important development is signing of the U.S.–Singapore Defense Cooperation Agreement (DCA) at the end of last year to allow for expanded security cooperation. In turn, the 2015 agreement builds on the 2005 Strategic Framework Agreement and the 1990 memorandum of understanding on U.S. use of military facilities in Singapore. So when the U.S. is looking to Southeast Asia to meet its strategic needs in the future, where is it likely to turn first? Singapore.

A similar case can be made concerning the Philippines. Although there are good strategic reasons for the tightening of U.S.–Philippines relations over the last five years—it is physically and legally right in the middle of the dispute over the South China Sea—there are also very good operational reasons why it would emerge be an American partner of choice. The U.S. and the Philippines have a formal treaty relationship going back to 1951 that has facilitated an enormous

amount of military activity over the years, across the range of shifting threats to their mutual interests. The relationship has a robust alliance bureaucracy led by the Joint U.S. Military Assistance Group (JUSMAG) in the Philippines and the legal framework of the 1999 Visiting Forces Agreement (VFA). Since 1999, the U.S. has also been deeply involved in the reform of the Philippines Armed Forces (PAF). In fact, since 2002 it has had hundreds of troops in the Southern Philippines supporting and training PAF counterinsurgency forces. And our contemporary connections go well beyond the characterization of the Philippines as the second front in the war on terror. The U.S. has long flown and sailed out of the Philippines' military facilities at Subic Bay, Clark, and elsewhere, even after the pullout in 1992. So last year, when the U.S. Department of Defense turned to implement the Southeast Asia Maritime Security Initiative (MSI) authored by the Senate Armed Services Committee, it is only logical that it would commit the bulk of its initial effort to the Philippines. Similarly, with regard to EDCA. Where else in Southeast Asia could the U.S. gain access to five military bases, and perhaps more, over ten years?

When the U.S. sought out new deployments of its Marines, it turned to Australia—a prospect long considered at the Pentagon and brought to fruition by the Obama Administration. Again, there is an extensive legal and operational framework that made the Marine Rotational Force-Darwin possible: The 1951 ANZUS treaty and a level of integration without comparison outside NATO. As with Singapore and the Philippines, there is also a track record. In the case of Australia, it is an extraordinary one of strategizing and operating together over a full century. This cooperation includes American access to a range of military facilities in Australia and Australian officers in the American chain of command at PACOM. In 2007, the U.S. and Australia signed and the Senate later ratified a Defense Trade Cooperation Treaty with Australia that streamlines the export of defense articles and services. Only the U.K. enjoys a similar arrangement with the U.S.

Standing at the end of the Obama Administration's second term, the U.S. is in a good place in its security relationships with all these countries: Japan, South Korea, Singapore, the Philippines, and Australia. Thailand is a special case. The U.S. also has very valuable, close alliance relations with Thailand. Complications in both strategic outlook and differences over Thailand domestic politics, however, have hamstrung the relationship in recent years. Its application to America's principal strategic concern vis-a-vis China is, therefore, limited. Its value today lies in practical cooperation across a range of issues from counterterrorism to humanitarian assistance and disaster relief. That and the prospect of future strategic alignment dictate preservation of the alliance. American military relationships elsewhere in the region are in good and improving condition. The Administration can count new defense-related initiatives in each of Malaysia, Vietnam, and Indonesia. These relationships, however, remain qualitatively the same as when the President took office, lacking the substantial legal and bureaucratic frameworks that will determine the future shape of America's military commitment to the region.

The Rebalance: Diplomatic and Economic

On the diplomatic side of the policy equation, the most notable facet of the rebalance has been the Administration's support for ASEAN as the center of an evolving regional diplomatic architecture. By way of quick recap, under the current Administration the U.S. signed ASEAN's

Treaty of Amity and Cooperation; became the first non-ASEAN country with a resident Ambassador to ASEAN; joined the East Asian Summit annual meeting of regional leaders; initiated the annual U.S.–ASEAN Leaders Meeting; joined the ASEAN Defense Ministers Plus process; and hosted the ASEAN Defense Ministers in Hawaii in 2014 and the leaders in California earlier this year. These tactical adjustments follow on the standard engagements that predate the Obama Administration like the Secretary of State’s attendance at the annual ASEAN Regional Forum (ARF) and Post-Ministerial meetings.

This is an impressive list of new American engagements. Their concrete value, however, is debatable. They have proven impotent thus far in addressing the substantial issues involved in the South China Sea, for instance. After a brief show of diplomatic strength at the ARF in 2010, the Administration has refrained from pushing the issue as strongly as required. Nevertheless, if quantity has a quality all its own when it comes to ships and planes, just showing up has a quality all its own in ASEAN. Vigorous participation in ASEAN forums positions the U.S. as a formal stakeholder in the future of the region. This is important, because whatever we may think about the efficacy of ASEAN, it occupies a central place in the foreign policies of the countries that comprise it. President Obama has set the table for his successor’s approach to regional architecture. The current level of American interaction with ASEAN can only be diminished at the cost of demonstrating American ambivalence about its commitment to the broader region.

The Administration has also expanded trilateral cooperation. President Bush initiated the most productive of these, the U.S.–Japan–Australia Trilateral Strategic Dialogue. The Obama Administration has maintained it and also inaugurated the U.S.–Japan–India trilateral. With the addition of a Japan–India–Australia trilateral earlier last year, the logic of these mechanisms seems to be taking hold. The four countries are now coordinating on a range of security issues in every configuration except all four meeting together. Such a quadrilateral dialogue was held once in 2007 and then abandoned. Such venues do not in any significant way constitute a move away from America’s hubs-and-spokes system of alliances as sometimes asserted by the Administration. The real bulk of work, both security-related and diplomatic, will continue to flow through American alliances and partnerships. They are, however, important coordination mechanisms.

Regarding economics, my purpose today is to simply note its strategic context. I have spent a good deal of my testimony talking about the military. And this is important. There are a number of flashpoints in the region and big geopolitical dynamics that require a strong and active U.S. military presence to safely manage. But the Asia–Pacific is mostly about trade and economics, and opportunity. Economic initiatives like the US–Korea, U.S.–Australian, U.S.–Singapore FTAs are about keeping the U.S. as relevant as possible to the life of the region. The U.S. must continue in the role of consensus driver on the rules and norms governing economic activity. It is a self-reinforcing proposition. The U.S. has the power to lead in rules setting because of our economic contributions, and we can make greater economic contributions because the open rules we favor facilitate greater American economic activity. If the United States opts out of this virtuous cycle, all of its activity on the political/security side will over time come to be seen as that of an interloper.

Going forward, the principal challenges on each of these accounts – military, diplomatic,

and economic – are more domestic than foreign. The challenge of maintaining capable forward deployed forces, for instance, is not access to new “places” in the Pacific; it is budgets. The Heritage Foundation in its annual *Index of U.S. Military Strength* has put the ideal size of the Navy at 346 ships. Today it has 271–272 and according to current plans, it will have 308 by 2022.¹ Heritage assesses that this is not enough to meet demands in the Pacific without new levels of risk, both strategic and tactical. Similarly, a recent study by Rand has put the time frame of China’s effective challenge to American dominance on China’s maritime periphery, in particular the South China Sea and Taiwan, at five to 15 years.² Readiness has also developed into a major problem over the past several years, as attested to by the service chiefs just this month.³ On diplomacy, the biggest challenge will be making the case to the next President that his presence and that of his Cabinet is regularly required on other side of the Pacific. And on economy, the challenge is a wavering Washington consensus on the value of free trade and potential deficiencies in the TPP.

Regional Response to the Rebalance

The regional response to U.S. policy is critical feedback. U.S. interests are immutable and the broadest strokes of strategy only slightly less permanent. Regional responses to the U.S. policy, however, are keys to adjusting tactics and shaping new approaches going forward. Responses to the Obama Administration’s rebalance can be characterized in two ways: support/facilitation and hedging.

The supporters/facilitators are most prominently Japan, Australia, Singapore, and the Philippines. After all, they are actually facilitating major parts of the rebalance. Each from a slightly different strategic angle, their governments have prioritized response to the China challenge. (South Korea is also a major supporter/facilitator of the U.S. presence, but its overwhelming interest is in cooperation vis-à-vis the threat from North Korea.) This does not mean they will buy wholesale U.S. policy prescriptions. It means they all want and expect more U.S. presence in the Asia–Pacific over the long term.

The Japanese are on the most concerned end of the supporter/facilitator spectrum. With Chinese incursions continuing regularly around the Senkakus, the challenge is proximate and immediate. As a result, the Japanese are prepared to be fuller partners in the alliance, as illustrated by Prime Minister Shinzo Abe’s defense reforms. It is constrained only by its awareness of constraints imposed by memories of the Pacific War. Japanese policymakers know to be nuanced in applications of Japanese assets to trouble spots like the South China Sea. They also know that the context of the U.S.–Japan alliance is critical to the way its increased energy is perceived in the region. Defense of its interests are, therefore, dependent on a healthy U.S.–Japan alliance and continued U.S. commitment to the region. This also means Japan is easily spooked by signals of American disinterest.

¹The Heritage Foundation, *2016 Index of U.S. Military Strength*, <http://index.heritage.org/military/2016/>.

²Eric Heginbotham et al., *The U.S.–China Military Scorecard: Forces, Geography, and the Evolving Balance of Power, 1996–2017*, The Rand Corporation, 2015, http://www.rand.org/content/dam/rand/pubs/research_reports/RR300/RR392/RAND_RR392.pdf (accessed March 28, 2016).

³John Sullivan and Justin Johnson, “America’s Military Is in Much Worse Shape Than You’d Think,” Heritage Foundation *Commentary*, March 25, 2016, <http://dailysignal.com/2016/03/25/americas-military-is-in-much-worse-shape-than-you-d-think/>.

Australia is only a notch or two removed from the most concerned end of the spectrum. There is no closer American ally in the world. It enjoys the luxury of distance from China, however, and can, therefore, afford to be more forward looking and strategic. The new 2016 Australian Defense White Paper is a perfect illustration. It explicitly attributes the past 70 years of peace and security in the region to American power. And it goes on to link Australia's fate with its continuing presence:

A strong and deep alliance is at the core of Australia's security and defence planning. The United States will remain the pre-eminent global military power and will continue to be Australia's most important strategic partner.... Australia will seek to broaden and deepen our alliance with the United States, including by supporting its critical role in underpinning security in our region through the continued *rebalance* of United States military forces.

Singapore has a long and openly expressed interest in the U.S. presence. Like many others, however, it also prioritizes its relationship with China. Singapore is a small, ultimately very vulnerable city state. Its foreign policy establishment is, therefore, always looking around the next strategic corner. It sees the rise of China as a geopolitical fact that must be acknowledged in order to maintain the peace and security of the region. By Singaporean calculations, the U.S. presence is essential to this. So too, however, are productive U.S.–China relations and intensive engagement of China through ASEAN and other regional institutions. It can be expected to continue balancing these things into a new American administration.

Manila has been very welcoming of the U.S. rebalance. This is for obvious reasons—it is currently on the receiving end of China's new aggressiveness in the South China Sea. Its stakes as a claimant are not matched by its military wherewithal and so it has fallen back on reliance on the U.S. Removed from near-hostilities with China, the Philippines would be much more of a hedger on the China policy spectrum.

This brings me to countries in the region I would characterize principally as hedgers. Among claimants in the South China Sea, there is a growing sense of concern with China. Vietnam and Malaysia are slowly embracing the rebalance and growing closer diplomatically and militarily with the U.S. Not incidentally, both are also part of the TPP. These relationships have been developing quietly for a very long time. Neither Malaysia, nor Vietnam, however, is willing to place their bets on the U.S. to the extent Singapore or the Philippines have. In the case of Vietnam, this may be because of extensive party-to-party relationships and the hesitancy of its defense establishment. It certainly has something to do with its land border with China. In the case of Malaysia, it may have to do most with political disarray at home and economics. There is also a worry in Kuala Lumpur that they could lean heavily on the U.S. only to be abandoned by this or the next American Administration. For its part, despite its recent dustup with the Chinese, Indonesia will likely continue to hedge on the U.S. presence in the region.

This spectrum of response from the most willing of facilitators to the most nervous of hedgers is very sensitive to signals from Washington. Strong signals—for example, healthy defense budgets, statements for support for alliances, Freedom of Navigation Operations (FONOPS), and well-conceived push back on Chinese aggressiveness reassure them to push

back in favor of a U.S.-led regional order. U.S. support for Taiwan is another critical signal. Not because most of the region shares America's concern for Taiwan, but because the region knows that a lessening of American commitment can only be attributable to concern for Chinese interests. ASEAN members in particular also view the personal involvement of the President and U.S. participation in regional diplomacy as signs of strength.

Signs of weakness, the ill-fated deal that the U.S. made with China over Scarborough Shoal in 2012, for instance, have the opposite impact. Hedgers like Malaysia, when faced with dilemmas over their own maritime claims, will be more timid in response for fear of provoking backlash from China. Presently, all are watching very closely indications that the Chinese may reclaim and build on Scarborough Shoal in a fashion similar to what they have done in the Spratlys. If it happens with no more than a diplomatic rebuke from the U.S., do not expect hedgers to step out in support of U.S. commitments. This is similar with regard to FONOPS. The region expects the U.S. to continue pressing its interest in freedom of the seas. A ratcheting back of this effort, another drawn out public handwringing or hedging on the part of the U.S. will dampen support for its presence. Finally, the region is looking for the parts of the rebalance that have been announced, arrangements with Australia and the Philippines, for instance, to be made good on and extended.

Recommendations

The preceding critique of the rebalance offers several recommendations for how the U.S. commitment to the Asia-Pacific can be sustained going forward.

- **Build more ships.** A 308-ship Navy is simply not enough to for the U.S. to maintain the necessary forward deployed presence in the Pacific, and the rest of its global commitments, in a way that effectively deters Chinese aggressiveness.
- **Follow through on all the current pieces of the rebalance.** This involves budget allocations on the U.S. side and continued monetary commitments on the part of our partners.
- **Maintain and expand participation in regional diplomatic initiatives,** including ASEAN-centric forums as well as other multilateral engagements like the Asia-Pacific Economic Cooperation, trilateral dialogues, and major summits like the U.S.–ASEAN Sunnylands summit. Revive the quadrilateral security dialogue.
- **Maintain a constructive relationship with China.** The region knows that American and Chinese interests often clash, and they expect the U.S. to stand up for its interests. They also, however, expect them to be addressed as peacefully and constructively as possible.
- **Be clear and consistent about American support for Taiwan.** The next few years may be very tense in cross-straits relations. The U.S. cannot afford to be seen as less than fully supportive, to include necessary defensive arms sales, of a responsible government in Taipei.

- **Keep the door open to a return to a normal relationship with Thailand.** There is a great deal of carrying capacity in the U.S.–Thai alliance. It is unknowable what the next U.S.–Thai strategic alignment will encompass. But just as the U.S.–Philippines alliance ultimately came into excellent use years after the neglect in the mid-1990s, it would be nice to have the U.S.–Thai alliance for a time when we share another major strategic priority.
- **Prod the South Koreans to think and plan more strategically beyond the Korean Peninsula.**

Conclusion

The Commission is very wise to hold this hearing on the rebalance. I am hopeful that the American commitment to the Asia–Pacific will continue long into the future. In order for that to happen in the most peaceful and secure manner, and in a way that extends the remarkable economic story of the region, it is important to take stock and make tactical adjustments. The Obama Administration did this with the Bush Administration’s strategy. It made policy improvements. In the process, it also made its own mistakes. Congress and the next Administration would do well to learn from both in order to put the American commitment to Asia on firm footing going forward.

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**OPENING STATEMENT OF DR. SHEILA SMITH
SENIOR FELLOW FOR JAPAN STUDIES, COUNCIL ON FOREIGN RELATIONS**

DR. SMITH: Thank you. I too want to thank you, Commissioners, for inviting me to address you today and to join my colleagues in the conversation on our policy towards Asia.

My understanding of the rebalance to Asia is that it sets new priorities for American foreign policy over the long-term. The United States must continue to work with allies and partners to sustain decades of peace that have underpinned Asia's economic success. So the rebalance, in my mind, is not the work of one administration; it's a work in progress that will carry over for at least a generation of American leadership.

Our priorities in Asia going forward are threefold. First, our own strategic interests are at stake in Asia, and so too are the interests of our friends and allies. We must maintain the ability to deter aggression and ensure that the efficacy of our extended deterrent is understood.

The security challenges arising from Asia are offset by the strength of our alliances and partnerships with the many nations of the region. Our alliance with the Republic of Korea ensures peace on the Korean Peninsula, the place where I think war is most likely in the region as we think about it going forward. And our forces organized together under the United Nations monitor the cease-fire agreement between North and South across the demilitarized zone.

Our strategic forces continue to deter Pyongyang from threatening Seoul, but we must be aware of the growing pressures on the extended deterrent.

Similarly, in our alliance with Japan, our strategic forces and cooperation on ballistic missile defense give Tokyo the confidence to eschew the nuclear option, even as its neighbors in North Korea and China seek to build and modernize their nuclear weapons.

Across Southeast Asia, the United States partners with many nations in providing regional security. Whether in recovery from natural disasters, such as the many typhoons and earthquakes and storms that threaten millions across the Indo-Pacific each year, or in protecting open and free maritime commerce across the region's seas and oceans, the United States and the nations of Asia share a common interest in preserving the peace.

Second, the United States must remain economically competitive in this vibrant and growing region. China's transformation has been nothing short of miraculous, and yet just as Japan's economic rise a century ago transformed the regional balance of power, so too is Beijing's newfound wealth and influence transforming Asia and indeed the globe.

The United States benefits greatly from an economically open Asia-Pacific. From the TPP to our bilateral trade pact with South Korea, to our negotiations on a bilateral investment treaty with China, the United States is poised to take full advantage of this economic opportunity.

I agree with my colleague, Professor Lampton, we don't need to participate in all economic institutions, but we should actively seek the opportunity to compete in the Asia-Pacific economy of the future.

Finally, I believe the United States must also lead in the development of viable regional institutions for dispute resolution. I believe you've talked about this at length this morning, but across Asia, territorial disputes have reemerged to challenge relations among states. Deeply provocative to the national identity of many in the Asia, these territorial disputes run the

risk of escalating into interstate conflict.

Already, Japan-China relations have suffered, as have China's relations with many of its neighbors. Developing risk reduction mechanisms for the militaries of Asia, as well as dispute resolutions to settle these competing claims, will help mitigate the potential for war. It will also demonstrate the lingering differences over past wars have been set aside and all nations of Asia are prepared to make a commitment to peace.

Let me talk a little bit now about the relationship I know best in the region, and about-- the Vice Chairman noted in my book, I have just written a book about Japan's response to this rising China.

More than any of our partners in Asia, Tokyo has welcomed our commitment to leadership in the Asia-Pacific. Three aspects of the rebalance are particularly important for the U.S.-Japan alliance: the reorganization of U.S. military presence; the completion of the TPP; and the U.S. effort to mitigate tensions between Japan and the People's Republic of China.

U.S. and Japan have been upgrading their military force posture since the mid-2000s. Cooperation, as I noted, on ballistic missile defense as well as the very recently upgraded U.S.-Japan Defense Cooperation Guidelines have produced better military coordination and crisis management mechanisms for the U.S. and Japan.

The U.S. use of rotational deployments and dispersal of forces across the Asia-Pacific has also created opportunity for Japanese military cooperation with other partners in the Asia-Pacific, such as Australia, the Philippines, and India. In addition, U.S.-Japan strategic cooperation with Vietnam and the other maritime nations of Asia is increasing.

The TPP may very well be the most important immediate aspect of the rebalance for Japan. In deciding to join TPP, in February 2013, Japanese Prime Minister Shinzo Abe not only signaled a willingness to participate in the new trade agreement but to also become TPP's leading advocate in the region.

In the months since the TPP agreement was concluded, the Abe cabinet has continued to ensure support within the Japanese parliament and among the Japanese people for ratification.

Finally, the U.S. rebalance to Asia promises a sustained and active American role in regional governance. The Chinese influence across the region--I'm sorry--as Chinese influence across the region increases, the U.S. commitment to a strong diplomatic and strategic presence in Asia continues to reassure Japan's strategic planners that its alliance with Washington will continue to be sufficient to meet Tokyo's deterrence and defense needs.

Nowhere was this more obvious than in the alliance response to the dispute between Tokyo and Beijing over the Senkaku Islands in the East China Sea. As President Barack Obama noted in 2014, these islands under the administration of Japan are protected by Article 5 of the U.S.-Japan security treaty.

The United States must continue to ensure that there is no room for miscalculation in Beijing. Whereas, the United States and China have concluded important military-to-military risk reduction agreements, the bilateral risk reduction agreement between Japan and China has yet to come to fruition. It is imperative that the United States continue to urge its conclusion.

In short, I have three very basic recommendations for Congress. The first, of course, has to do with the TPP. I think once ratified, this will ensure that the United States remains anchored in an Asia-Pacific economy designed for free trade and inclusive growth. I'm not here to argue the details of the TPP, but I think it is an important indication of our willingness to anchor ourselves economically in this region.

Second, perhaps it will surprise no one in this room or in the broader Congress that the presidential election has occasioned grave concern among our allies and partners in Asia. Indeed, some of the comments about some of our long-standing alliances with Japan and South Korea have already shaken some of the foundations of confidence.

Congress in this year of presidential transition, I believe, has a particularly important role to play in reassuring our alliances. Equally important, I think we can also resolve to uphold our treaty obligations.

And, finally, as this panel and today's discussions demonstrate, it is incredibly important that we sustain an open and active bipartisan conversation on our future in Asia. We can't invest more in the future of our country.

Thank you.

**PREPARED STATEMENT OF DR. SHEILA SMITH
SENIOR FELLOW FOR JAPAN STUDIES, COUNCIL ON FOREIGN RELATIONS**

Opening Statement

U.S.-China Economic and Security Review Commission
Hearing on the U.S. Rebalance to Asia

Sheila A. Smith
Senior Fellow for Japan Studies
Council on Foreign Relations

The United States' interests in Asia are long-standing and deeply rooted. Our economic vitality depends on trade with and investment in the dynamic economies of the Asia-Pacific, and that dependency will only increase in the decades ahead. Our largest trading partners are in Asia; our overseas investments are increasingly concentrated in Asia; and Asian nations hold the bulk of American debt. Japanese companies provide around 800,000 jobs for American workers each year, making Japan the largest Asian investor in the U.S. economy, second only to Great Britain.

Our strategic partnerships in Asia not only strengthen our national security, but also ensure peace across the region. Our military alliances with Japan, the Republic of Korea, and Australia have ensured stability in the region, and provided opportunity for our military forces to train and exercise alongside some of the most accomplished militaries in the world. Our many security partnerships with the countries of Southeast Asia provide humanitarian assistance and disaster relief across Asia. All of these relationships allow the U.S. military to operate with ease from the Pacific Ocean through to the Indian Ocean and ultimately to the Gulf of Hormuz, safeguarding stable sea lanes of communication and open access to resources and trade with most of the world.

To date, the Obama administration's rebalance to Asia has had three strategic consequences. It has bolstered the U.S. diplomatic, economic, and strategic presence in Southeast Asia; it has strengthened our alliances in Northeast Asia to meet new geostrategic challenges; and it has added our considerable diplomatic weight to the collective task of building effective multilateral regional cooperation. The rebalance has also produced a new high standard trade agreement, the Trans-Pacific Partnership (TPP), with twelve other nations that could vastly transform the regional economy. The TPP has yet to be realized, but U.S. leadership in this initiative is critical to the future economic success of the region.

Implementing the Rebalance

The rebalance to Asia sets new priorities for U.S. foreign policy over the long-term. The Asia-Pacific is not only the most dynamic region in the world; it is the future hub of the global economy. Strategically, the potential for geopolitical contest among the states of Asia could change the trajectory of world politics. A new rising global power is unsettling the region and creating new demand for regional cooperation. The United States must continue to work with

allies and partners to sustain the decades of peace that have underpinned Asia's economic success. Understood in this way, the rebalance is not the work of one president. It must be seen as a continuous effort, a work-in-progress, for American foreign policy makers.

Our priorities in Asia going forward are threefold. First, while our leadership in ensuring peace and stability across the Asia-Pacific cannot be underestimated, it is our own strategic interests that are at stake in Asia. We must maintain the ability to deter aggression, and some of our greatest strategic challenges are to be found in Asia. The proliferation of nuclear weapons by North Korea and the increasing capacity to deliver those weapons across continents pose a serious threat to our nation's security. The growing military capabilities of the People's Republic of China (PRC) are also of concern. China has long been a nuclear power, and it is now acquiring conventional military capabilities that may impede the U.S. military in the Pacific. Beijing's focus on asymmetrical weapons designed to inhibit our ability to meet our defense obligations to our allies cannot be ignored. New capabilities in space and cyber will also affect the global strategic balance.

The security challenges arising from Asia are offset by the strength of our alliances and partnerships with the many nations of the region. Our alliance with the Republic of Korea (ROK) ensures peace on the Korean Peninsula, and our forces organized together under the United Nations monitor the cease-fire agreement between North and South across the demilitarized zone. In addition, our strategic forces continue to deter Pyongyang from threatening Seoul, and alongside the ROK military, the ability of U.S. forces to maintain peace on the Korean Peninsula is more important than ever to regional stability.

Similarly in our alliance with Japan, our strategic forces and cooperation on ballistic missile defense (BMD) give Tokyo the confidence to eschew the nuclear option, even as its neighbors in North Korea and China seek to modernize their nuclear arsenals. Through generous Host Nation Support and the provision of indispensable bases and facilities, communities in Japan host nearly 53,000 members of our military.

Across Southeast Asia, the United States partners with many nations in providing regional security. Whether in recovery from natural disasters, such as the many earthquakes and storms that threaten millions across the Indo-Pacific each year, or in protecting open and free maritime commerce across the region's seas and oceans, the United States and the nations of Asia share a common interest in preserving the peace.

Second, the United States must remain economically competitive in this vibrant and growing region. China's transformation has been nothing short of miraculous, and just as Japan's economic rise a century ago transformed the regional balance of power, Beijing's newfound wealth and influence have been transforming Asia and the globe. The United States benefits greatly from an economically open Asia-Pacific. From the TPP to our bilateral trade pact with South Korea to our negotiations on a Bilateral Investment Treaty with China, the United States is poised to take full advantage of this economic opportunity. As the rules of commerce continue to be rewritten in the twenty-first century, the United States must be at the forefront of crafting new global standards and practices that ensure free and fair trade. We do not need to participate in all regional economic institutions, but we should actively seek the opportunity to compete in the

Asia-Pacific economy of the future.

Finally, the United States must also lead in the development of viable regional institutions for dispute resolution. Across Asia, territorial disputes have reemerged to challenge relations among states. Deeply provocative to the national identity of many in Asia, these territorial disputes run the risk of escalating into interstate conflict. Already Japan-China relations have suffered as have China's relations with many of its neighbors. The Association of Southeast Asian Nations (ASEAN) has sought to develop a code of conduct in the hope that the competing claims to the islands, reefs, and shoals in the seas of Asia will not lead to military conflict. As China's military capability grows so too does the anxiety over how that power will be used. Developing risk reduction mechanisms for the militaries of Asia as well as dispute resolution mechanisms to settle these claims will help mitigate the potential for war. It will also demonstrate that the lingering differences over past wars have been set aside and all nations of Asia are prepared to make a commitment to peace. The United States is the largest military power in Asia, and as the guarantor of the security of many Asian states, we must continue to lead this effort.

Several challenges lie ahead for the United States. First, the United States must modernize and maintain sufficient military capability to defend its interests in the Pacific, and this includes air and maritime forces as well as the capabilities of the new domains of space and cyber. Second, the United States must remain a leader in the promotion of a prosperous and equitable global economy. Finally, the United States must help design and build the institutions that can facilitate the peaceful resolution of conflict. Isolationism is no longer an option for the United States, and this is particularly true for the Asia-Pacific. If we are to remain competitive in the twenty-first century we must be able to compete effectively in the Asia-Pacific.

The U.S. Rebalance and Japan

More than any of our partners, Tokyo has welcome our commitment to leadership in the Asia-Pacific. Three aspects of the rebalance are particularly important for the U.S.-Japan alliance: the reorganization of the U.S. military presence in Asia, the completion of the TPP, and U.S. efforts to mitigate tensions between Japan and the PRC.

The United States and Japan have been upgrading their military force posture since the mid-2000s in response to the changing security environment in Northeast Asia. Cooperation on BMD as well as the upgraded U.S.-Japan Defense Corporation Guidelines have produced better military coordination between U.S. and Japanese forces, and have enhanced the readiness of the alliance to cope with the emerging threats from Pyongyang and potentially from Beijing. Japan's own defense reforms have enhanced their air and maritime capabilities especially in the intelligence, surveillance, and reconnaissance missions (ISR). Japan's priorities of BMD and island defense have also led to a deeper conversation in the alliance about crisis management protocols. The U.S. use of rotational deployments and dispersal of forces across the Asia-Pacific has also created opportunity for Japanese military cooperation with other partners in the Asia-Pacific, such as Australia, the Philippines, and India. In addition, U.S.-Japan strategic cooperation with Vietnam and other maritime nations is being considered.

The TPP may very well be the most important aspect of the rebalance for Japan. In deciding to

join the TPP in February 2013, Japanese Prime Minister Shinzo Abe not only signaled a willingness to participate in the new trade agreement but also to become TPP's leading advocate. In contrast to previous bilateral trade talks, the United States and Japan were largely on the same page when it came to TPP rules. While market access was carefully negotiated across the twelve nations, Japan's participation ensured that if successful the TPP would represent somewhere on the order of 40% of the world's economic activity. In the months since the TPP agreement was concluded, the Abe Cabinet has continued to ensure support within Japan for ratification.

Finally, the U.S. rebalance to Asia promises a sustained and active American role in regional governance. As Chinese influence across the region increases, the U.S. commitment to a strong diplomatic and strategic presence in Asia continues to reassure Japan's strategic planners that its alliance with Washington will continue to be sufficient to meet Tokyo's defense needs. Nowhere was this more obvious than in the alliance response to the dispute between Tokyo and Beijing over the Senkaku Islands in the East China Sea. As President Barack Obama noted in April 2014, these islands under the administration of Japan are protected by Article 5 of the U.S. -Japan security treaty. The United States must ensure that there is no room for miscalculation in Beijing. Today both Chinese and Japanese Coast Guards patrol the territory long claimed by Japan. National sentiment in Japan has rallied around the sovereignty dispute, as has sentiment in China. Waters between Japan and China today are home to an increasingly large number of Japanese and Chinese naval vessels and aircraft that come in regular contact in and around the disputed islands. After several years of virtually no diplomatic activity, Prime Minister Abe met with President Xi Jinping to agree to create a risk reduction mechanism for their militaries across the East China Sea. Whereas the United States and China have concluded a military-military risk reduction agreement, Japan-China agreement has yet to be announced. We should continue to urge its conclusion.

Recommendations for Congress

The United States has long been a Pacific power, and our future is intimately linked to the partnerships we have built in Asia. From the devastation of World War II through the Cold War, the United States has played a decisive role in building a regional order in Asia. Our partners and allies continue to depend on the United States even as the region undergoes transformation. Our own prosperity and security will depend on our ability to navigate Asia's geopolitics.

The rebalance to Asia must continue beyond this President's administration, indeed beyond his successor's time in office. Crafting a sustainable Asia strategy for accomplishing this, however, will require deep understanding of the dynamics of the region. A sophisticated diplomacy will be necessary if we are to navigate the complex currents of geostrategic change. It is perhaps our greatest challenge in the decades ahead.

Several recommendations for Congress come to mind. The first and most obvious is the realization of the twelve-nation agreement on the TPP. Once ratified this will ensure that the United States remains anchored in an Asia-Pacific economy designed for free trade and inclusive growth.

Second, perhaps it will surprise no one in Congress that the presidential election has occasioned

grave concern among our allies and partners in Asia. Indeed, some of the comments about our long-standing alliances with Japan and South Korea have already shaken the foundation of confidence in the United States. Congress, in this year of presidential transition, has a particular role to play in reassuring our allies that commitments of the United States remain true. Equally important, Congress can resolve to uphold our treaty obligations.

Finally, the United States Congress is critical to the success of our global leadership. As we face increasing unpredictability abroad, the Congress's role in deliberating on and contributing to the national debate on America's future could not be more important. This debate must not take sides and divide the nation; the American people need their Congress to present thoughtful bipartisan debate on the difficult choices ahead in a world that is increasingly complex and increasingly volatile.

PANEL III QUESTION AND ANSWER

VICE CHAIRMAN BARTHOLOMEW: Thank you very much.

We'll start with Commissioner Wortzel.

COMMISSIONER WORTZEL: Thank you all for being here.

Mike, let me ask you, if I could, if, if China's actions and diplomacy are so opposed to what you see as its interests, where is the failure in Beijing? I mean is it, is it a foreign minister and a State Council vice chairman that simply don't know what's going on? Is it a failure of policy analysis in the National Security Council system there or national security? In other words, they're not dumb. They're obviously quite happy with what they're getting or they'd change. Ten years ago, their diplomacy and military posture really was very effective.

And I mean I have--it's kind of a rhetorical question. How many amphibious landing forces and amphibious ready groups does the Court of Arbitration in The Hague have? So what I'm trying to say with that is it doesn't matter what the Court of Arbitration decides. My personal view is that the Chinese will begin reclaiming land in Scarborough and putting in features before or on the heels of the Philippine presidential election, maybe before or soon after the Court of Arbitration decision.

So what we need to do or we need to devise, and I hope you can help with this, are ways to get allies and ASEAN and other littoral states to agree on a way to make Beijing pay for those actions because the Court of Arbitration can do nothing.

DR. LAMPTON: Okay. Let me take the second question first because I have less to say about it, and I think the first one is a really interesting question--Why is China behaving in ways that somewhat dispassionate observers would say is not in its own interests?

As to The Hague, I'm a realist. I realize that The Hague has no armies, has no bailiffs to go out and enforce the judgment. Of course, that's not unique to that international judicial body. That's characteristic of the broader international court system. But I would say, I think first of all China has shown it cares a lot what the arbitration board says because it's made a big deal about it. So, for whatever set of reasons, the Chinese care.

There also is a great debate going on in China. There's a big constituency in China for being a respected member of the international community and not being seen as a pariah. There are a lot of people in China who do not want to be seen that way. So I think at least it's, The Arbitration Court, sending a message.

Thirdly, how many armies does the Pope have? What he's got is justice or some ethical construct; right? Just because you don't have a navy doesn't mean you don't have influence. So that's about as far as I can go with that one.

But the other question, that is why is China behaving in ways contrary to its interests, I think there are probably a lot of reasons: First of all, there are different understandings of what China's interests are in China. In my written testimony, I talk about the fierce dimension of debates. There are a lot of Chinese who say, What on earth is making this alignment with Russia at the loss of Japan, the United States, Australia, the Philippines, where is that in our strategic interest? Right?

So there is a debate. That's my point. But it seems that the less constructive forces have the ascendancy, now, so we have to explain that. Why are those forces in ascendancy? I suppose, first of all, you have to say that this tendency started a little before Xi Jinping came into power, but it has gained momentum under Xi. I think most people, most Chinese I talk to, would agree with that. So it has something to do with the leader, and it's a

system that amplifies the views of the leader, and he's certainly done his best to control policy.

One of the first statements Xi Jinping made after coming to power was that China will play a bigger role. If you want to ask what his policy is about, it's about China playing a bigger role and pushing out or consolidating what the height of the Qing Dynasty boundaries were basically. And you ask, well, why is he pushing that? I think one reason is he's still consolidating power domestically.

I hear all this talk about Xi Jinping being the strongest leader since Mao. I don't believe that. It may prove to be true in some future here, but I don't believe that's true at the moment. I think you're seeing an insecure leader build nationalistic support for what he's doing internally. So I think it has a lot to do with his, the succession, the 19th Party Congress coming up in 2017, and so forth. Domestic politics counts. It would be the same as saying, well, our foreign policy and what the president puts before Congress has nothing to do with the elections. I mean you wouldn't believe that for the United States.

So, anyway, I think it has a lot to do with domestic politics. You mentioned coordination. Xi built the National Security Commission, I think in part, and only in part, to better coordinate Chinese foreign policy between the provinces, Hainan Island, the fisheries and coast guard forces, the PLA Navy—there are lots of actors. Hainan Island wants to extend its control into the South China Sea.

So there is a problem in controlling all these actors. Xi tried to create a National Security Commission. It has not, as far as I can tell, been very well institutionalized yet. He's got a lot of opposition to creating a National Security Commission. So like everything else, China's leaders can control a few things when they really want to, but it's at the cost of not paying enough attention to other things.

So there are a lot of factors, but I think that coordination problem, the character of the leader, are primary, and domestic politics.

VICE CHAIRMAN BARTHOLOMEW: Dr. Smith.

DR. SMITH: Thank you.

Just a brief response to the question on the arbitration and The Hague if I may. We just concluded a new pact with the Philippines. It gives us closer access. We're a little bit more willing and ready to be visible, especially on Scarborough.

I wanted to also point out that Japan, too, has now been exercising with the Philippines with their navy and with their coastal defense forces, which are limited. Japan has also contributed money to helping to build capacity there and will be giving and has already given some Coast Guard ships to the Philippines.

I wanted to just point out on the question of The Hague and whether or not UNCLOS has teeth and whether we can do anything about it, we have our own debate on that subject--I'm well aware of that--ever since President Reagan made the decision in the 1980s on UNCLOS, but I think it's also fair to say that UNCLOS matters deeply to our allies. So Japan has ratified. Other countries in the region have ratified. China has ratified.

When Foreign Minister Wang Yi was in town a few weeks ago, he made a point of the fact of saying we have ratified, but you have not. So there is a little bit of moral authority questioning here, but there's also the utility of the norms that UNCLOS embodies, and I think that's something for us to consider seriously.

Thank you.

VICE CHAIRMAN BARTHOLOMEW: Walter.

MR. LOHMAN: Just very quickly on the issue of Scarborough Shoal, I mean sort

of imbedded in your question, Larry, is a fait accompli. It hasn't even happened yet. Okay. I mean the Chinese building on Scarborough Shoal and militarizing the island. And it kind of gives you a sense of where we have gone on this whole issue, maybe out of our impotence over the other features, in the Spratlys.

But I don't think we have to start from that point. I mean why not park an American destroyer at the Scarborough Shoal? That's one option. The Chinese are not going to come through an American destroyer. I don't know how long you can keep it on station, but you can put it there to make the point because I think this is actually an inflection point in our involvement in the region and in the rebalance.

It will make us look weak if we just continue to do FONOPS and we continue to criticize them in ASEAN and we do all these other things, when on the ground or in the water, they're actually creating facts right in the face of it, and it will impact the way the rest of the region sees us.

Recent developments aren't just pushing partners and allies our way. We also have to be pulling them. Once they come, we have to show them that we're here for them. Otherwise, they might not come our way. You know the fear and the concern could actually push them back in the other direction if we don't play it right, and I think Scarborough is a key point in this effort.

VICE CHAIRMAN BARTHOLOMEW: Thank you.

Chairman Shea.

CHAIRMAN SHEA: Thank you very much for your testimony.

I will note that the Pope may not have an army, but he does have the Swiss Guard and the Jesuits so--

[Laughter.]

CHAIRMAN SHEA: They're the Pope's marines.

But Larry kind of took--Colonel Wortzel took my question. But I'll follow up with you, Dr. Lampton. From what I heard you say is that China is acting in what you perceive as contrary to its self-interests because the decision-making authority is centered in a single individual who--by the name of Xi Jinping--who thinks this is a good idea, and despite the fact that he's pushing countries in the region into closer relationships with the United States. Is that, is that accurate?

And then it sort of raised in my own mind--I just read a book by David Shambaugh, China's Future, and he says China's future is very bleak if it maintains its--both economically and as an actor on the world stage if it doesn't become a more open society, and maybe not move towards a democratic system but at least a more open system that allows different voices within the society to engage. So I'm wondering what you think of that?

And I have a very specific question for Dr. Smith, and that is if you could give us just a status update on the South Korean-Japanese relationship?

DR. LAMPTON: To your first question, yes, I think you captured the essence of my meaning, which is that Xi is important, and he's aggregated unto himself the what I call cross-sectoral committees in charge of trying to coordinate, and he's put himself in the key slots. And therefore he's more central, there's less consensual decision-making and more individual decision-making. So that's the core of my argument.

What I would want to elaborate on is what I meant about domestic politics; I think Xi thinks this is not only what he can do, wishes to, but it's also good politics.

CHAIRMAN SHEA: Uh-huh.

DR. LAMPTON: And this plays well "in Peoria" in China, so to speak. I mean Chinese people I think are supportive--I mentioned nationalism spreading in Asia. I don't think China is the only place this is happening, and I see this to be dangerous actually. But it is true in China and you'll find very widespread nationalistic support. When I talk to ordinary people, they think Xi is standing up against corruption and standing up for China playing a bigger role, and getting back its territories—in their view this is good, it is right.

CHAIRMAN SHEA: Uh-huh.

DR. LAMPTON: And so this isn't a guy without any political support, which is a kind of an inconvenient fact. So I think it's a combination of a leader who has got the levers, he's got the desire, and he's got a lot of popular support. It would be an easier problem if he were totally disconnected--

CHAIRMAN SHEA: Right.

DR. LAMPTON: --from the views of the society, but unfortunately I don't think he is entirely disconnected. Now, however, I think there are lots of practical Chinese, particularly in the leadership broadly, the broader elite, who think these islands in the South and East China Seas aren't worth, you know, getting crosswise with all these people. But as a popular statement, I think, at least until there are costs, it will be popular or at least have its base of support.

CHAIRMAN SHEA: Uh-huh.

DR. LAMPTON: On the bleak future, look, I guess I think that the last 40 years of reform have changed China. There's now a middle class of various dimensions--let's just say 350 million. That's as big as the U.S. population. They've got right now over 300,000 students at all levels in the U.S. and like numbers in Japan and Europe. This is a different society. It was a peasant society 40 years ago; it's an urban society today.

You've got all these entrepreneurs with investment. So I think the only viable way is to build a system that's better able to govern pluralism. I'm carefully not using the word "democracy." But a system more capable of taking into account a broader and broader diversity of views. I think that's what they've got to do, but I wouldn't say China is not going to grow if it doesn't do that in the next five years. This may be a 20, 25 years, I think it's probably going to be 25, 30 years, it's going to be decades, not years.

And China still has 400 million people to urbanize. China has got a vast unexploited domestic potential market so I'm not going to stand here and say if they don't have elections the day after tomorrow or next year, they're not going to grow. They've grown without democracy, and I think for awhile they can continue to. Maybe growth is going to slow down because it's all getting bigger, and I think they'd do better if they had reform. But I'm not going to sit here and say if they don't do, you know, what we think they ought to be doing politically, they're not going to grow.

I think we have to count on China being moderately successful at growing. I think that's the future we better plan for.

CHAIRMAN SHEA: Uh-huh. I agree.

DR. SMITH: Thank you.

Let me address your questions about South Korea and Japan. As you know, from 2012, the dissonance between the two countries was exacerbated. Prime Minister Abe, President Park came into office early--after elections in 2012, they came in early in 2013 with really not a very comfortable conversation and no obvious way to get to a bilateral summit.

The United States stepped in and facilitated a trilateral summit--President Obama,

President Park and Prime Minister Abe. But the diplomatic estrangement between the two countries was serious. It's only this last year that they've managed to meet each other, and as we speak today, the three leaders, President Obama, President Park and Prime Minister Abe, are holding a trilateral meeting.

The core causes and the future prospects are obviously war legacy issues. In South Korea, many of the grievance of the victims of Japanese colonization and the war are not using the courts to adjudicate those differences. They're putting pressure. That court system is also putting pressure on the executive branch of the South Korean government to reopen the conversation, a conversation that was concluded in 1965 in the peace treaty.

So on the so-called "comfort women" or on POW compensation, these are things that the South Korean court has gotten very active in. So the domestic politics shouldn't be underestimated here.

Japan and South Korea concluded an agreement at the very end of last year on the comfort women issue in an attempt to resolve the outstanding differences on that. It's still a very sensitive topic in both countries, but I think both governments have a very strong interest in leading that to conclusion.

Last year, as you know, was the 70th anniversary of the end of World War II so across Asia, these countries, the high diplomacy, the summitry, and the visits to Washington really included this component for our policymakers of historical reconciliation in Asia. I would only suggest that it's not always about the past. It's very much about the current geostrategic change and how these legacy issues are being reinterpreted by new generations of Chinese, of Koreans, of Japanese.

And I think in the younger generations, especially in South Korea, this issue of the Japanese colonization and wartime treatment is quite at the forefront of their national identity debate. Again, it's not a position our policymakers are used to being in the middle of, but I would alert you to a speech made by Deputy Secretary of State Antony Blinken a couple of days ago at Brookings where he presented the fruits of about 18 months of trilateral conversation on how to bring the three countries together in a global agenda and including the reconciliation issue. So we have some work to do on that, I think.

CHAIRMAN SHEA: Thank you.

VICE CHAIRMAN BARTHOLOMEW: Great.

Commissioner Wessel.

COMMISSIONER WESSEL: Thank you, all.

A number of questions, but Dr. Smith, let me take advantage of your knowledge of Japan, if I can, and inject a question that has come off of the presidential campaign recently about continuing U.S. support for our military assets there. Do you believe those military assets are necessary for Japan to support or share U.S. interests? It seems that we have aligned interests vis-a-vis China already that the military assets there may enhance that, but are they necessary?

Are those who are arguing that maybe we should rebalance the cost of those assets, and I should also point out I'm an appointee of Mrs. Pelosi, so that the people who are arguing are not necessarily people I support, but are they so far off? I mean is it necessary?

DR. SMITH: I think it is necessary to have U.S. forces forward deployed in Japan, and let me give you a couple of reasons why. We have 53,000 men and women in uniform in Japan so they serve on our only aircraft carrier that's home-ported out of the United States, outside of the United States. So Japan has hosted one of our major assets in the 7th Fleet for decades, for half a century almost.

So, yes, I think it's in our strategic interests that our forward deployments in Japan continue. I think we've been working through several administrations now on reconfiguring those forces in a way that updates them to meet the strategic challenges. They're not all about the defense of Japan, and what we've done also is to try to reconfigure, especially the U.S. Marines, but reconfigure other forces to make sure that they're effective but that they're not actually not able to be used in other capacities.

I would point out that I don't have the exact number, but we've just concluded a five-year agreement with Japan on what's called host nation support, which basically covers 50 percent of the cost, not salaries, right, not the kinds of things that comes out of the United States' taxpayer dollar, but their operating costs in Japan are largely supported by Japan, not by the United States.

So the costs of us operating there, I mean leaving aside force posture adjustments and the size and number of forces, the costs of us operating there continue to be supported by the Japanese taxpayer, who values that immensely.

I think it's not only our interests so obviously it's Japan's interests, right, and I alluded to this in my written testimony. Japan relies on the United States for a strategic deterrent. Japan does not have offensive strike capability. It has eschewed that. It has not developed a nuclear option because it relies on the United States.

If we were to change that strategic bargain, whatever the arguments pro or con may be, Japan would have to rethink its post-war defense policy. As you know, Article 9 of the Japanese constitution, the constitution that General MacArthur wrote in 1947, basically commits Japan only to self-defense. They've interpreted it a very limited armament for the purpose of territorial defense.

If we are to change the terms of the alliance and especially fundamentally alter our willingness to sustain a forward deployed force there, Japan will rethink its own defensive needs and postures.

COMMISSIONER WESSEL: But its self-interest is the same. The base of my question is their self-interest is the same. The modalities or the tools to achieve those are what we're really talking about. We were in Vietnam, some of us were in Vietnam last summer, and it seemed clear to me at least that Vietnam was worried about Chinese expansionism, what happened with the oil rig, et cetera, and that U.S. enhanced role there, whether via TPP, et cetera, might be beneficial, but it was not going to buy Vietnamese views and attitudes towards China.

Many in the region are already worried about China. So those who are arguing for different approaches to the region seem to have some valid points. Again, strengthening the relationships in any of a number of ways has value for other reasons, but we're not buying the views of our allies there. Is that?

DR. SMITH: Absolutely not. And again I hope you didn't misunderstand my comment to say--I'm--

COMMISSIONER WESSEL: No, no, no. I'm trying to think through this.

DR. SMITH: --thinking out loud.

COMMISSIONER WESSEL: Not challenging you.

DR. SMITH: No, I understand. I think a lot of times this kind of burden-sharing debate gets reduced to that. It gets reduced to we need to buy, you know, you need to pay us more so we'll keep our forces there, and it's very transactional. And that's the problem I have with the burden-sharing argument frankly. Absolutely, yes, we should talk to our allies about their contribution to the shared defense, not of their country, but of the mission in the region.

And I would say that Japan does its share, but maybe we can ask it to do some more. And absolutely we can get into, I won't get into the details of what we could do more. But that's a different conversation than saying carry your own weight; we're not going to be there for you.

And, you know, I think the varied responsibilities of our forces in the Pacific and beyond because, again, they operate from Japan all the way across the Indo-Pacific, so our interests here are not just about the defense of Japan. Our interests are whether or not that aircraft carrier gets to go out to South Asia and through the Gulf of Hormuz. It matters in the South China Sea and the access in the Philippines.

So our ability, our 7th Fleet's ability, working with the Japanese Navy gives us a projection capability and a presence that we just wouldn't have. So it's not just about Japan when we talk about the forces that are in that country, and I think the Japanese are very ready and very prepared to have a very serious conversation about what organization of military forces will enhance the deterrent, jointly, but also our presence, but will also make sure that they're ready to deal with anything that may be coming their way.

And one piece of the alliance that I think a lot of Americans don't appreciate is in the Cold War our forces were there largely for Cold War strategic games, the Korean Peninsula, tensions across the Taiwan Strait. We are now in this kind of fluid post-Cold War era with the rise of China, with nuclearization on the North Korean, on the Korean Peninsula, when we're having to think about perhaps a use of force incident against Japan that's different than in the past.

So the Japanese military is not there to support us alone. They are really now much more interested in war planning, if I could be very blunt about it, and in thinking through the way to anchor the United States, but also think positively about the constructive kinds of capabilities it can develop to make sure that that's possible.

So I think we're at a moment with this conversation in our alliance with Japan, similarly as we've had recently with Korea, it's a great moment to talk about not just who pays what, but how do we effectively get the job done in the region? So that would be my answer, long-winded answer to your question.

COMMISSIONER WESSEL: No, it's very helpful. Thank you.

DR. SMITH: You're welcome.

VICE CHAIRMAN BARTHOLOMEW: Thank you.

Commissioner Fiedler.

COMMISSIONER FIEDLER: Mike, I wanted to probe your earlier comments on the internal decision-making, and you were emphasizing Xi's domestic motivations, and it seems to me that those, if true, that what he's doing in the South China Sea is motivated by sort of domestic politics, that when he runs up against a wall with us, the implications domestically for him are huge.

Now, that leaves, in my view, too much room for miscalculation. Now, historically, we have been the ones who sort of say, okay, they're teenagers, they're adolescents, we'll tolerate a certain level of misbehavior. It now has gone, it seems to me, much beyond that where we can't tolerate certain levels of behavior, and if they don't get that, then we have a real problem.

So I get back to where I was this morning in discussing their calculations, their intentions, what's motivating him, and is it built-in miscalculation?

DR. LAMPTON: First of all, I think the front page of the New York Times--I

mentioned it earlier--deals explicitly with that, and it was quite a long transcript on just the communications between the naval vessels--

COMMISSIONER FIEDLER: I read it actually last night.

DR. LAMPTON: So I think you had two questions, but I'll go with the second one on the room for miscalculation for a minute. I'm very worried about that, and I think in my both oral and certainly my written testimony I mentioned the danger of miscalculation, and I've asked Chinese colleagues recently if we had an EP-3 incident now, would it be resolved in the 12 days that it was resolved the last time, and would we be able to contain it? And I haven't met a Chinese yet that thinks it would be nearly as easy to manage now as it was when the incident happened in 2001.

So I think there are Chinese that are worried about the miscalculation. I've had military officers, I've been in discussions with military officers that have talked about how difficult it is to control essentially young adolescent males out at the end of the command-and-control system so they seem to worry about that problem of control.

But the stark reality is that China has more and more actors, I don't want to say flooding the zone, in football parlance, but they've got a lot of assets out in the region. They've got their agricultural and fisheries authorities, their coast guard, their navy, and then I would say sort of ad hoc numbers of civilians. You know, I think about 70 percent of the oceangoing vessels China has are actually private, and the room for trouble there is very great.

In this charged, nationalistic, election-driven environment, it's going to be very difficult to manage it. If somebody gets killed here, it's going to be very difficult to manage in both societies. I think it's going to be more difficult.

COMMISSIONER FIEDLER: Let me just add to my question whether you believe that they think we lack the will to take a harder line? I mean I would comment that the administration in the last four or five months has been taking many more actions that demonstrate our will than in the previous year. Okay.

But I don't know--you read a lot about their perceptions of our decline, and you got the president has got less than a year left, you got all kinds of things going on here, and do they, in fact, do you pick up that they think we lack the will?

DR. LAMPTON: Well, different Chinese have different views. They're having a debate about how much will does the U.S. have; how much capacity does the U.S. have; is the U.S. in decline; isn't it in decline? These are all active debates, so not all Chinese agree on this.

COMMISSIONER FIEDLER: I'm talking about leadership.

DR. LAMPTON: I think the Chinese now see us as, certainly if you compare it to 2008, 2009, when we had those severe economic challenges, I think that was the high point of where the Chinese--and they did well dealing with that crisis and the investment they made, and it's pumped up their economy. That was really at the height of what I would call Chinese arrogance.

If we had that mentality now, I would really be worried. I think the Chinese now have many more domestic problems, they understand this themselves, and they see us as more resilient than they might have in 2008. So, I don't think this is the worst time in the sense of their attitude towards us. Further, I agree with your observation that since really October, we've sort of, I don't want to say toughened our spine, but maybe that's a way to put it, and you'll note in my testimony that I said in October, we had this unfortunate debate, do we cross the 12-mile limit around Subi Reef, and there were people in the U.S. government that wanted to and those who didn't. And it got kind of painful. Why didn't we just do it; right?

And so I think we've toughened up a little. I think Beijing is becoming more appreciative of our resilience. And what really bothers me rather than a command-and-control Beijing decision to have a conflict--or to test us militarily--is that you're going to have somebody out at the end of this command-and-control chain that does the wrong thing. That's what I'm more worried about, this week at least.

VICE CHAIRMAN BARTHOLOMEW: Dr. Smith, do you have something to add?

DR. SMITH: Just a very little footnote to your question, sir. It's not just about us interacting with the Chinese. I'm worried about the Japanese and the Chinese. So you could see there--

COMMISSIONER FIEDLER: Yeah.

DR. SMITH: --we have these mil-mil agreements and we're having difficulty, but there's also an awful lot of heightened interaction between--

COMMISSIONER FIEDLER: Flying over in I mean Japanese airspace.

DR. SMITH: Right. Both sides.

COMMISSIONER FIEDLER: It's a big deal.

DR. SMITH: Right.

VICE CHAIRMAN BARTHOLOMEW: Okay. Dr. Brookes.

COMMISSIONER BROOKES: Thank you very much, and thank you all for your testimony.

I have a question for each one of you. Mr. Lohman, I looked at your testimony quickly. I first had a chance to take a look at it today, and in your oral remarks--maybe I missed it--but I noticed you didn't mention Thailand at all. And I thought if you didn't, I thought it was kind of conspicuous by its absence, and I wondered where Thailand fits into all of this.

Dr. Lampton, I'm always cheered by your cautious optimism about things, and I, and your idea of reciprocal engagement--

COMMISSIONER FIEDLER: I thought he's never been more pessimistic.

[Laughter.]

COMMISSIONER BROOKES: And the idea of reciprocal engagement. But my view is, is that in many cases when our interests don't align with China, we're not involved in a win-win situation as we often are as Americans but more of a zero sum game.

But my question to you is, is I was wondering if you could put a little more context into where you think Sino-Russian relations might be going? This is something that's always been a long-term interest of mine. I think there's a lot of issues in there, and I think you may have been thinking they were better than they were so I'd like to hear a little bit more about it.

Dr. Smith, one quick comment. As somebody who was involved with host nation support at the Pentagon and also having served in Japan, it's pretty important, and I hope--is your 50 percent--do you feel confident in that number of non-personnel costs is what Japan is currently paying? I'll let you answer that after I ask you the other question.

But host nation support is critically important, especially at this time, considering the United States is dealing with sequestration and other theaters of operations, and that money allows the United States to put more money towards its military and its capability. So it is very, very important, especially in difficult times.

The question I have for you is you said that you thought that or you said that Japan's Navy was operating with the Philippines today or was that the Coast Guard? I wanted to

make sure I was correct in hearing that.

And do you expect to see Japan doing any patrols in the South China Sea or any Freedom of Navigation Operations in the South China Sea? So with that, I'll yield to your answers.

Thank you.

MR. LOHMAN: All right. Can I just say briefly on the point about the cost of our presence in Japan and how to, whether or not our commitment continues? It's funny that some of the people who make the assertion that we ought to bring troops home are also the same people who want a strong defense. So I'm not sure, you know, where you're going to put them. Okay. You have 53,000 people. You got to put them on a base somewhere; right?

It's worth asking those people what the cost is of bringing them home? And actually, it's not just that the Japanese pay for half of the non-personnel costs. It would actually cost us a great deal to bring them home and to maintain them in the United States long-term. Or you just change our strategy completely and we determine that we don't need, you know, 53,000 men and women in our armed services and cut the whole thing and all the ships and the 7th Fleet and everything else. But otherwise it would cost more.

On Thailand, it actually is in my written testimony. I'm so glad I turned that testimony in three days in advance.

[Laughter.]

COMMISSIONER BROOKES: I didn't get it till this morning.

MR. LOHMAN: I'm just joking. Yeah. I mean the thing is with Thailand is that we're at sort of a strategic departure with the Thais on China. The Thais just don't have the same priority or the same way of looking at China as we do. I mean from our perspective, there's upsides, there's downsides. It's a complex relationship with the Chinese, and we've got these very tense issues at hand with the Chinese. For the Thais, it's almost entirely upside. They see very, very little downside in the relationship.

So I think the role of the alliance with Thailand is around a lot of the other things it has capacity to do--HADR; the use of their facilities; they allow us to use U-Tapao. You know they allow us access, and that access comes in very handy sometimes so I think we need to maintain the alliance in a robust way so that we can use it when we need it. So we had this similar kind of impasse developing already, but then we had the wars in Iraq and Afghanistan, and Thailand played a very significant role in that.

So we just have to I think hold steady with them and realize that they're not quite in the same place we are on the whole China thing.

COMMISSIONER BROOKES: Dr. Smith.

DR. SMITH: On the host nation support, no, I'm not confident on the 50 percent figure, and I don't want to represent it as my research. But what I would point out from the 1980s when Congresswoman Schroeder was running the burden-sharing panels, you have a very different argument today about the amount of money that Japan contributes. And in this recent round of host nation support, the reorganization of forces and the building up of facilities in Guam and the Japanese contribution to that effort was included in the conversation of how much does Japan contribute.

So you're right to be skeptical about that large number, but I do think it's important to understand that a lot of the on-the-ground costs can be tracked, and those are the operating costs that I was thinking of. I'm not an economist. I don't track these in minute detail, but I do take your point.

COMMISSIONER BROOKES: Yeah. I admit I've lost visibility on the issue in terms of the numbers. Actually 50 percent seemed low to me, but it--

DR. SMITH: It is. Yeah.

COMMISSIONER BROOKES: But there are other things going on. Perhaps Guam or--

DR. SMITH: Right.

COMMISSIONER BROOKES: --the Okinawa relocation, that sort of thing.

DR. SMITH: Yeah.

COMMISSIONER BROOKES: So it might be at that point.

DR. SMITH: And we've come a long way since it was the opportunity costs for base, land and things like that as a calculus. Now it really matters in terms of our consolidation--

COMMISSIONER BROOKES: Right.

DR. SMITH: --so forgive me for the broad-brush stroke.

On the Philippine side, Palawan, is there were concurrent operations--exercises--between the Japanese Navy, Maritime Self-Defense Force, and the Philippines, and us in the Philippines. We didn't do it trilaterally. We did it in parallel about the same time. The Japanese Coast Guard, as you know, is very busy defending the Japanese waters at the moment, especially with the new group in the Senkakus. So they don't go overseas to train very often, but there are conversations, and there is this capacity building exercise.

On the FON in South China Sea, I'm not sure--Prime Minister Abe said one thing one day and then said something the next day so I understand the official Japanese position to be that they were not ready for FON, Freedom of Navigation Operations.

I think most people in the Japanese security planning community and indeed in ours don't think it's wise for the Japanese to do FON actually. It would be too much of a target, I think, of opportunity for China.

On the South China Sea, though, there is a conversation between Japan and Australia, Japan, Australia and us, and, as you know, the Japanese Navy transits the South China Sea to go to the Gulf of Aden for their multilateral antipiracy so they have kinds of reasons to be in the South China Sea without actually calling it something against the island reclamation project.

But Australia and Japan is where I pay attention to anything that might be forthcoming in the near term, perhaps trilaterally, but clearly bilaterally as well.

DR. LAMPTON: Peter, on your two questions, one is the observation about relative optimism of the phrase "reciprocal engagement," and then I saw Jeffrey say, well, this is more pessimistic than I've seen him. What I was really saying in plain English, or what I want to say in plain English, is that we can argue when China was poor and weak that we were going to have to--you almost intrinsically ended up doing things that turned out to the net benefit of China without being overly worried about exactly who got how much out of the transaction.

Those days are largely over, and we have to be concerned about equitable reciprocal agreements. So, for example, to have thousands of Chinese media here and us have trouble getting three major newspapers visas, that, whatever "reciprocity" is, that's not it. So that's what I mean. One hand washes the other, and now we have two more equal hands. If China is going to be a daguo, a big country, then it has to act like it. Right?

So I don't see that as soft or hard; I just sort of see it as fair, and the situation has changed. So I don't know what we call that--pessimism, optimism, whatever.

As to Russia, the way I would put it is that China has a situation of strategic

alignment with Russia, and we, the United States, have, Japan, Australia, and all our other friends-- I'd much rather have our group of friends than their friends. So I think they've made a strategically not great choice here.

Now if you ask me what do I think about the potential of that choice, actually I think it's structurally very weak, and there's lots of contradiction. Russia and China are natural competitors in Central Asia. China wants low oil prices, Russia wants high oil prices; Russia wants to have diversified markets, China wants to monopolize; and just right across the board they have conflicts of interest. Russia doesn't want to sell the highest technology weapons to China because of fear about the future; right?

So it gets to my general view that when Russia and China are close to each other, the U.S. must be making a mistake because we're driving two skeptical powers towards each other. So I don't know what I conveyed, but basically I don't see Russia-China as a marriage made in heaven. We have the capacity actually to be friends with more countries than they can obviously be with each other. China-Japan. Russia-China. So we ought to be smart and use this structural advantage--that's why I said we ought to be more confident--so much of our discussion sounds like we're on the ropes--with an IV in our national veins or something. I don't think so.

VICE CHAIRMAN BARTHOLOMEW: All right. Thank you.
Senator Talent.

HEARING CO-CHAIR TALENT: Thank you.

Mr. Lohman, bravo for your recommendation about increasing the size of the Navy. You also mentioned the importance of keeping attention on Taiwan as there's a transfer, as the transfer of power has occurred there. So I think I'd like you to elaborate a little bit about what concerns you have, how you think China is going to respond, if you would?

Dr. Smith, thank you for explaining the Japanese-American alliance so well, and I'll just add, I actually wrote a column about this a couple of days ago in response to the person that my colleague over here was too kind to mention, the leading candidate for my party for president, and I was very critical, but I mean the key to this alliance is the linchpin, a foundation of an approach to the Western Pacific that safeguards America's vital national interests or it isn't. Okay. If it is, and I believe it is, then surely the most important thing about it is not whether Japan is paying a little more than a third, which I think--well, actually they pay now about 40 percent, or whether it goes up to 50 percent.

Plus there's--and I'll just add this--you know, American servicemen and women are volunteers, but they're not mercenaries. Okay. If the only purpose of this really is to protect Japan, we don't hire them out to other countries, you know, to replace militaries that they don't want to build. They're not the Hessians. So if that really is the only thing we're doing with them, then we ought to bring them home.

We don't say, oh, well, we'll hire our people out and put their lives on the line if you pay a little bit more. My gosh. Okay. That's the end of my rant.

[Laughter.]

HEARING CO-CHAIR TALENT: But would you--what I would like you to elaborate on because you're so knowledgeable, what's the position of the Abe government back home? And from what I can tell, he's been maneuvering, and his government is maneuvering very effectively, but I also know that there are protests. How do you foresee that going on in the future and does that depend in part on the perception of America's commitment and leadership? So if you would expound on that, I'd appreciate it.

And Dr. Lampton, you can feel free to weigh in. It's just that I feel like everybody has been peppering you with questions. So I'd go to the other two.

MR. LOHMAN: Well, on Taiwan, what I tried to do in my testimony was evaluate the rebalance with an eye to the future and sustaining the U.S. commitment to the region long after people cease to call it the rebalance. We'll basically have the same policy; how do we approach it?

And I think on Taiwan, the administration, they deserve credit for the ten, \$12 billion, maybe up to \$14 billion now, in arms sales that they've made to Taiwan over the last seven-and-a-half years. But they have left a couple of very big important things on the table, one, fighter aircraft for Taiwan. They need new fighter aircraft. And their interest in submarines, which is now, darn, it's over 20 years now they've been asking. It's to the point where they're proposing to build their own submarines, which I don't even know is possible, but if it is possible, it's going to cost a heck of a lot of money.

So I think a new administration coming in should focus immediately on arms sales to Taiwan, and in so doing send a message to the Chinese that a new administration is going to do what it has to do, and that's going to be the basis on which our relationship rests. That is that we do the things that we need to do in our national interests, and then we can talk with the Chinese about other things. Otherwise what happens is you start the process and you start the dynamic with the Chinese early on, and then it gets harder and harder and harder to do all the other things that you need to do.

So I would suggest a new administration come in immediately and take the tough choices on Taiwan. In order to make that happen, we need a willing, responsible partner in Taiwan, and I think we have one. I think Tsai Ing-wen will allow us to move forward in ways that we couldn't move forward the last time the DPP was in power.

DR. SMITH: Thank you, Senator, for your questions. I appreciate your point of view on the alliance, and I am grateful for it.

I think also many Americans don't understand that our forces in Japan would be, in warfighting terms, we would need those bases and facilities if anything happened in Korea.

HEARING CO-CHAIR TALENT: Sure. I think it would cost more if we brought them back to CONUS and rotated them in a continual basis. Now there are people who will argue with you that that's not the case or argue about with me about it. But I think in any event, the difference between what we're paying now and what we would pay, it's fractional.

DR. SMITH: Right.

HEARING CO-CHAIR TALENT: And the Japanese are--if there is a conflict, they would be on the front lines.

DR. SMITH: Right.

HEARING CO-CHAIR TALENT: So we should take that into account, too.

DR. SMITH: Yeah.

HEARING CO-CHAIR TALENT: That's a burden. That's a risk they're assuming.

DR. SMITH: Exactly. Thank you so much for that.

Let me talk a little bit about your question about Mr. Abe. As you know, he came in in a sweeping election in 2012. He then called a snap election in 2014, which was largely about his economic agenda and specifically the consumption tax. He didn't have quite the voter turnout that he wanted, but he had, again, a two-thirds majority in the lower house of parliament, which gives him a legislative, a pretty free hand.

Public opinion polling runs anywhere between 50 and 60 percent, but consistently since the time he took office in December 2012. For a Japanese Prime Minister, you appreciate that that's almost unheard of in the last two decades.

So the times that that public opinion polling dipped was when he took on some of the issues that the Japanese public feels very sensitive about. So the National Security Law in 2013, and then last summer when the new security legislation went through the Diet, very tumultuous time, and as you saw on TV, people outside protesting against what they called Abe's war bills. So this is all about the Japanese constitution and the Japanese people's loyalties to Article 9 and the fear that Japan will become again a military power.

So on these very critical sensitive issues, you see Japanese feeling very strongly about his choices. Does this relate to the perception of U.S. leadership? I'm not sure. I think he has been very successful in bringing the alliance to the forefront of the Japanese public's understanding of why it's so vital to them and to their security.

When he came to Washington last year, he spoke to a joint session of Congress. He talked to our representatives, right, about TPP and about his ag reform package. So he equally addressed our concerns about some of our bilateral issues, but really the Japanese people today if you look at polling on the alliance, I think CSIS has a report, and I may be misquoting the exact number, but they have it on paper. It's somewhere about 80 percent to 85 percent of the Japanese people believe that this alliance is in their interest.

So I don't think that we should worry about a perception of U.S. leadership, but I think we should appreciate the fact, as we were talking about earlier, Japanese anxiety about their defenses is real and palpable, and I think Abe has taken the country a long way in reforming some of the key defense initiatives, security, the Security Law, the collective self-defense debate, relaxing defense technology cooperation with other countries.

You may or may not know that the first item they tackled is submarines with Australia. It's a huge issue for the region; right? So he's not going about this in a halfhearted manner. He's attempting to address some of these defense concerns.

Last point of clarification, if I may, on the collective self-defense right. So this is a reinterpretation of a government interpretation so it's not rewriting the constitution; right? In the 1970s, the Japanese government at the time interpreted their constitution to say that the Japanese Self-Defense Forces could not operate jointly with the United States or with any other national military for that reason, in the use of force, that they were strictly a territorial defense military.

Today, clearly, that's not viable. If you look beyond Japan in the maritime domain and the regional areas, Japan has a lot of strategic interests at stake, and it needs other partners, and this government has recognized this.

So the collective self-defense debate is really about in a very limited way still attached to what the government perceives as Japan's security needs, when and how the self-defense force can operate with other militaries. It's largely good for the alliance, but it also allows Japan to participate in peacekeeping operations more fully, to join with the ASEAN countries in humanitarian and disaster relief operations.

So it's still very tied to this notion of Japan not being an offensive military power, but it allows the self-defense force a little bit more latitude. I think what we're going to see is in implementation they will keep pushing a little bit more and little bit more, but I think there will be a very ginger relaxation of the activities under this new reinterpretation, and we should watch it carefully. But for the U.S.-Japan alliance, I think it's a positive sign for us.

VICE CHAIRMAN BARTHOLOMEW: Quickly, Dr. Lampton.

DR. LAMPTON: Just a quick comment. We've agreed about so much here, but there was one point, if I understood Dr. Lohman correctly about the sequence of how we address Taiwan in the next transition period. It would be my understanding that the current administration is going to, is, in fact, going to make a weapons transfer of some significant scale to Taiwan, or at least authorize that.

I think that then gives the new administration a bit of a breathing spell, not force them into an immediate decision, the most incendiary part of our relationship, or at least an incendiary part of our relationship.

The last eight years, whatever one wants to say about the outgoing government in Taipei, we have at least not had the Taiwan Strait be a very major problem for the U.S. So, I don't think I would advise making Taiwan more of a problem now--we've got enough problems with China all over the map. I wouldn't want to send the first message of a new administration to be that we are going to enlarge the area in which we want controversy. I think we can live with the status quo that's existed over the last eight years.

If I were the incoming administration, whatever it is, I would be grateful if the outgoing administration didn't leave me with a problem, instead made the hard decision, whatever is going to be transferred, give me some time.— Also, Xi Jinping, what's he going to decide about Taiwan? We don't want to drive him in a bad direction, and he's sort of sent mixed messages. So I'd let that sleeping dog lie.

VICE CHAIRMAN BARTHOLOMEW: Great. Okay. Dr. Tobin.

COMMISSIONER TOBIN: Great. Thank you, Chairman.

Being near the end of the list of questions, mine has been somewhat addressed, but let me thank you all, first of all, for the testimony, and then I want to pursue a question with Dr. Smith, and others of you can amplify..

As a Commission, as you may know, we travel to Asia each summer to learn. We were last in Japan in the summer of 2013. We were also in South Korea at that time. It was very clear to me that Japan was somewhat contained and not actively working to build bridges with neighboring countries. Now in 2016, three years later, as you've outlined, Doctor, Japan is working closely with the Philippines. There are arrangements between Japan and India, Japan and Australia, Japan and Taiwan, Japan and Vietnam.

Tell us, if you would, diplomatically and politically, how has that come about so quickly, possibly even in the last year, and is it Abe dependent? If you could just shed light on that, please?

DR. SMITH: Thank you for that question.

You know I hope you get a chance to go back to Japan this summer. I hope the Commission goes because I think what you'll see there is a fairly fulsome debate on Japan's future. You'll hear an awful lot about China. You'll hear an awful lot of worry about us. So I think it's a good time to talk to the Japanese about their perspective on the region.

So Japan has long had close relations with many countries in Southeast Asia. You can go back to the 1970s and the Fukuda doctrine and the outreach to the countries of Southeast Asia. Largely, these were designed and thought about as deep economic ties but also cultural and people-to-people exchange.

So Mr. Abe hasn't made all this up all of a sudden. A lot of the diplomatic opportunity has come from reigniting a little bit of energy in the relationships. As you know, from 2009 to 2012, there was another party in power in Japan, and they were very internally

focused. So when Mr. Abe came back into power, the diplomacy didn't necessarily change, but he kind of accelerated a lot of opportunities that were waiting for leadership.

His theme is "Japan is back." He came here in Washington in February 2013 to say Japan is back. I think Mr. Abe is back, and so he has leadership, I think, both the parliamentary foundation but also the leadership skill I think in the diplomatic area that some of Japan's previous prime ministers have not had. He likes it. He's on the road a lot.

He's been to Southeast Asia I think at least three times and not just the bilaterals but in a sweeping tour. He speaks at the meetings in Singapore, the ASEAN Regional Forum, and the IISS meetings. So he has been a big advocate for Japan's diplomatic engagement with the region.

On the Philippines, Vietnam, and India, these are strategic interests. His predecessor in the other party also had a strategic dialogue with India. I think in the context of today's Asia, it's drawing a little bit more attention, and it's also specifically the India relationship. Mr. Modi has sought out Mr. Abe, so there's a little bit of like-mindedness among the leaders there.

But I think the large focal point here is just maritime Asia. Japan is a maritime country. It sees its security in terms of the Indo-Pacific maritime region. It gets 90 something percent of its imported energy from the Gulf of Hormuz, and it's now beginning to feel comfortable and has the capacity, frankly the capabilities, to reach out to partners around the region.

The Philippines and Vietnam have focused on Japan as a partner, just as they have focused on us. So there's a lot of opportunity there. I don't think it's Mr. Abe specific to be honest with you.

COMMISSIONER TOBIN: Right.

DR. SMITH: There's an election this summer that I failed to mention to Senator Talent, but there's an election coming up this summer. We may get a little bit of feedback on where the country is on Mr. Abe's defense and strategic initiatives but also on its economic planning. So we'll get a chance to take a peak at home to see whether this is being supported by the Japanese people this year.

COMMISSIONER TOBIN: As I hear your thinking, it is also the diplomatic movement and the coming together of several countries. It serves him politically.

DR. SMITH: Yes, it does.

COMMISSIONER TOBIN: Yes.

DR. SMITH: And, you know, we have been advocates. I think our panelists here have shared that sense of the need for collective action in the region, and Japan feels very much that it can contribute to that collective action.

COMMISSIONER TOBIN: Thank you.

VICE CHAIRMAN BARTHOLOMEW: Wonderful. Echoing Dr. Tobin, when you come at the end of these questions, and I'm trying to pull together several different streams as well as having several specific things, and I would ask--we're supposed to end at ten minutes to three, and I don't know if our witnesses could extend that just for another few minutes because we have a couple of people who would like to go for a second round?

Dr. Lampton, as I was listening to you talk about sort of there are reasons why China and Russia don't have the same interests, I was struck by the fact that I mean one interest that they do perhaps share is the worldwide defeat of the liberal order. You know, they're both autocratic governments, and it just seems to me that we can't diminish the significance of

something like that.

I have a specific question, though, on something else you had about reciprocity, and I wonder, do you also support reciprocity in the world of trade, trade relationships?

DR. LAMPTON: Yes, unless there's a technical meaning to "reciprocity" that I don't understand. Sure, I get very uncomfortable when the Chinese service industries have unfettered access to the U.S., and our service industries have very limited access. I just did a study of the 94 CEOs who wrote President Obama prior to the last summit asking for a bilateral investment treaty and access to China. You know, 21 percent by my count of those CEOs came from the services industry, very narrowly defined, and the finance area.

And so, yes, if that's what you mean by reciprocity, I entirely subscribe to it.

VICE CHAIRMAN BARTHOLOMEW: Okay. And I guess one of the biggest themes I've seen coming from here, it sort of gets to the interests of, or gets to the issue of a perception, certainly one that I have, over the course of the past 25 years, that China acts in its self-interests--countries do--but that often decisions that have been by the United States and its relationship with China have actually been in China's interests and not necessarily in the interests of people here.

And I think of some of the trade agreements, and people might disagree with me, but I just wonder how, how do you--and I'll open this to everybody, Dr. Lampton, though, it's sort of the issue you put out there, which is reciprocal engagement. How do you--that requires cooperation on the part of both parties, and so I would say that we have been engaging in China in a way that they have not reciprocated generally, but is it in our power to be able to get them to reciprocate? That's a premise of your reciprocal engagement.

DR. LAMPTON: This gets complicated, but what is reciprocity? I think it's getting equal value in some transaction somehow defined. So we have 324,000 Chinese students here. We have, let's say, 7,000 there. I don't know. I may be off a thousand either way. Now, if that's your number, it would not seem reciprocal. Now, of course, you could divide by five because they're five times as big as the U.S. population wise. But the point is we have an \$8 billion revenue from all those Chinese students here. One reason there are a lot here is because they're paying full tuition. So we have to be careful how we define reciprocity.

VICE CHAIRMAN BARTHOLOMEW: Right.

DR. LAMPTON: So is that a reciprocal? If we look at it as an export industry, we've actually got a big balance of trade surplus here. So I don't have a narrow-minded sense of how you define reciprocity--but in the end, each society has to be content with the proposition that all things considered, over a reasonable amount of time, this is a two-way street, not a one-way street.

And as China is getting richer, the excuse for any preferential treatment I think goes down. Reciprocity in international affairs is an example; if China doesn't want to help on North Korea, okay, but then don't ask Japan and the Republic of Korea and the United States not to try to protect themselves through whatever means we think appropriate. I guess THAAD seems to be the latest answer to that question.

What I mean is that we've got to look out for our interests. That's what I really mean.

VICE CHAIRMAN BARTHOLOMEW: Okay. And Dr. Smith, you mentioned dispute resolution mechanisms. In some ways, it's the same underlying issue as just in this question about reciprocity, which is dispute resolution mechanisms are essentially a social compact. I mean they require both the participation of parties and then the agreement that the

parties will abide by what the dispute resolution mechanism comes to.

And I guess I just, here I sometimes just see such a gap between what China says it will do and what it actually does, the gap between the thought that's expressed or the message that they think people want to hear and what actually happens on the ground, and I don't know. I mean how do you mediate--how do you just not create another mechanism that doesn't accomplish anything because say, for example, the Chinese just decide, well, we're not going to do it?

DR. SMITH: It is the question of the Asia-Pacific at the moment. Thank you.

I'm not very optimistic to be very honest with you about the current dispute resolution mechanisms, and again I'm not an international legal specialist. But two things strike me. I teach a course at Georgetown on island disputes in Asia, and so we are amply full of current events every year about U.N. Law of the Sea; right?

It does not have any teeth; right? It is a voluntary agreement that everybody has joined into with varying degrees, as Foreign Minister Wang Yi reminded us, of subscription to the notion that UNCLOS has a place in these disputes.

The ASEAN has tried to come to a regional conversation and an agreement on a code of conduct for the South China Sea; right? Just the other day, the Indonesian Foreign Minister spoke out about China completely sabotaging the dialogue on the code of conduct by coming into Indonesian waters with the Chinese Coast Guard and getting in between a Chinese fishing boat that was being towed by an Indonesian Coast Guard.

So I'm not--this is not an optimistic moment for either regional or international dispute resolution mechanisms. However, if you look at other regions outside of Asia, even when people weren't very optimistic about the U.N. and its ability to resolve these disputes, countries end up sometimes coming to the U.N., to say we want to get rid of this problem. So Indonesia and Malaysia went and got rid of a problem. They decided it wasn't in their interest anymore.

All kinds of countries in Europe have done the same thing. At some point, China may find that the blow back I think that Dr. Lampton pointed out is not in their interest. So we should at least have in our arsenal of opportunity some dispute resolution mechanisms that could do it.

The problem with UNCLOS, in my mind, and again it's not an informed legal point of view, it's just as I look more at it, it's an emerging regime. It's not a fully formed regime. And I think that's what the Philippine arbitration case is really all about. It's not about whether or not the Philippines wins against China, but it's about the fact that we all support a rule-of-law-based international order.

And I agree with you, it's not going to solve our problems if China doesn't want to participate. But I think creating the mechanisms is the first step to saying to China our interests and your interests are in resolving these disputes peacefully. If we can't negotiate them bilaterally, then let's create the mechanisms and vehicles for either third-party mediation or for some kind of neutral place.

And so I think we just need to keep building at the options. If they choose not to use those options, so be it. We have to think about other options, other courses of action. But I wouldn't rule it out yet is I guess my long answer to your question.

VICE CHAIRMAN BARTHOLOMEW: Thanks.

And I'm going to take the prerogative of the chair and ask another question before I recognize Dr.--oh, no, I guess Commissioner Wessel will be next and then Dr. Wortzel.

Walter, I'm going to sort of start this with you, but it's kind of summing up what we've been doing. You made a comment about long after the rebalance has served its purpose, and I'm wondering if you could define what the world looks like with a rebalance that has served its purpose, or is it more, again, we don't even need to call it a rebalance because it's just put the policy where it needs to be? I mean how do we know that the rebalance--when do we decide that the rebalance has been successful?

MR. LOHMAN: Well, the way I think about the rebalance is that it's basically this administration's formulation of the American commitment to the Asia-Pacific. It's not really anything strategically innovative or earth-shattering. It's just this follow-on to the things that had preceded it. It's covered with a lot of rhetoric. Some of that rhetoric actually grew out of the campaign in 2008 and continued.

So the way I see its purpose is just continuing our commitment to the region because when you really start to break it down, and you start looking at the individual pieces of it, the biggest pieces are actually things that were begun before and continued--things like the realignment of marines on Okinawa and Guam, things like the realignment of forces in Korea. Even the marine deployment in Australia is something that's been around for a long time.

So it's just this administration's way of kicking our commitment into the next one, and then the next administration kicking it into the one after that.

VICE CHAIRMAN BARTHOLOMEW: So I hope that the next administration, whoever it is, does have a commitment to continue it.

MR. LOHMAN: Yeah.

VICE CHAIRMAN BARTHOLOMEW: So Commissioner Wessel.

COMMISSIONER WESSEL: I have a fairly quick question. Dr. Lampton, being a believer in reciprocity and, in fact, I believe it was last year's report of the Commission which highlighted reciprocity as a worthwhile tool, you mentioned the journalists. How would you execute that? Would you begin refusing visas for Chinese journalists here? Would you kick out journalists? How do you, in fact, implement such a policy?

DR. LAMPTON: Good question, and there have been discussions that have happened at several different NGO fora on exactly this. Let us start by saying that even the U.S. media world itself doesn't agree on this. You have owners of mass media that want to preserve their access and stand for openness, even as doors close to them--

COMMISSIONER WESSEL: You have Washington Post which likes the how many tens of thousands of dollars they get every week on this, on the inserts.

VICE CHAIRMAN BARTHOLOMEW: And our constitutional commitment to freedom of the press.

COMMISSIONER WESSEL: Yes.

DR. LAMPTON: Yes. But there are some--I'm going to answer your question.

COMMISSIONER WESSEL: Yeah.

DR. LAMPTON: But there are some competing values out there. Don't we net benefit by getting Chinese exposed to the U.S. even through the distorted filters that are applied, and isn't that a benefit to us? And so even if we're treated unfairly, isn't, in fact, the projection of America back in China a big plus for America? I think the answer is yes.

And so I'm not inclined to actually say you toss reporters out--and I would correct for population. China is a much bigger place. But all that set aside, I'm not inclined to start by tossing out Chinese journalists. But, why do we have to have big delegations of front office people from Xinhua coming through all the time?

I mean actually it's not the Chinese reporters here that are deciding who gets visas; right?

COMMISSIONER WESSEL: Uh-huh.

DR. LAMPTON: So let's look at the front office and what we can do there. I mean that would be just a start.

COMMISSIONER WESSEL: Okay. I appreciate the thought. A more creative approach. Thank you.

VICE CHAIRMAN BARTHOLOMEW: Actually I think it looks like we're going to be ending on time because Dr. Wortzel has decided to pass. Oops. Okay. I'm sorry. Oh, yeah, he's abandoned his question.

So thank you very much to all of our witnesses. It's been a really interesting hearing. We look forward to continuing discussion with you about these issues, and there might be some more questions forthcoming. But thank you for all the work that you do and thank you for participating today. And with that, we'll close the hearing.