

**Hale Report: Episode 11**  
**US-China Relations with William Overholt**



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**0:00:10.6 Lyric Hughes Hale:** Welcome to the Hale Report. This is Lyric Hughes Hale, Editor-in-Chief of EconVue. We are a podcast series that is located in Chicago. And we welcome you today, January 18th, 2021. Our guest today is William Overholt. Dr. Overholt is an expert in US-China relations. He's now senior research fellow at Harvard University's Kennedy School of Government, he was previously at RAND Corporation where he was the Head of the Center for Asia-Pacific policy, and spent 21 years in investment banking, working as the head of strategy at Nomura's regional headquarters in Hong Kong. He's a prolific writer, and I think he's writing a new book. We'll ask you to tell us more about that as we talk together. And he is also the principal at his own firm, AsiaStrat LLC. So I'd like to welcome Bill.

**0:01:12.4 LH:** Bill, we've known each other a while, and I've been meaning to ask you a question, how did you originally get interested in Asia? I ask this of many of the people I interview and I find that there's sometimes some good stories around that.

**0:01:28.5 William Overholt:** About the time I graduated from high school, my father took a position with a small university in the Philippines, Central Philippine University in a town called Iloilo. And so I accompanied him there for a year, I was planning to be a mathematician or mathematical physicist, but I got there, and it turned out I knew more math and physics than any of the local professors, so I studied Philippine dancing for a year.

[laughter]

**0:02:11.8 LH:** That's amazing.

**0:02:13.3 WO:** It's the only time I've ever been first in my class, and I spent a lot of time with missionaries up in the hills, where there were some very primitive tribes, and I discovered there were things in the world that were at least as interesting as math.

**0:02:36.0 LH:** So that's how you got the Asia bug. It was through Philippine dancing.

**0:02:40.5 WO:** Yes.

**0:02:41.2 LH:** Well, that is, I think, the most unusual story I have heard.

[laughter]

**0:02:48.1 LH:** And we'll have to ask you to share some photographs of that sometime. No, but that's a delightful story. Thank you for sharing that. I thought it was really particularly appropriate to ask you to speak with us this inauguration week, as we might be having, experiencing a change in US-China policy. And going from the Obama administration and then the pivot to... The pivot that was supposed to take place to Asia, what happened with the Trump administration, and now

looking to the future. So thinking about those questions, I saw an article that you wrote for The Wire China called Myths and Realities in Sino-American Relations. And I think this might be a great way to approach understanding what might happen in the future.

**0:03:46.5 LH:** But you have six myths, I believe, and I wonder if you'd mind talking to us about them and how you see the world maybe a little bit differently than others, and how this might impact future policy. So your first myth is that President Trump said that cutting off all relations with China would save us \$500 billion, and can you tell us why that didn't happen?

**0:04:18.7 WO:** Well, President Trump thought that along with his advisor, Peter Navarro, who should have known better, that the trade deficit is a measure of relative benefits from trade between two countries, and any economist knows that that's not correct. The famous example is that if China assembles the pieces of a Nike shoe for Nike and sends them back to the United States, the trade balance shows plus \$100 for China and minus \$100 for the US, but actually only \$2 of benefits stay in China for assembling the shoe, and most of the rest of the benefits go to the US for designing, marketing, financing, all the other things other than assembly. So based on this misconception, Trump focused on the trade deficit and launched this trade war that was supposed to bring manufacturing jobs home and benefit Americans.

**0:06:01.5 WO:** The result of this trade war was that manufacturing employment went down in the United States because, for instance, raising the price of steel had a small benefit for the steel companies, but a huge cost for things like car companies that actually employed far more people. So his policies tremendously increased the trade deficit, decreased manufacturing employment, and raised costs for American families, the cost of living, between \$600 and \$1200 per person.

**0:06:47.8 LH:** So what you're saying is, we were looking at an entirely incorrect metric to measure what we were doing and it was counterproductive, I guess, in fact, for US interest.

**0:07:00.9 WO:** Yes.

**0:07:01.0 LH:** So your next myth, our engagement with China, and this is one of my favorites, was based on this idea that economic engagement would lead to political liberalization in China, and if that's not going to happen, then the engagement has failed and should be reversed.

**0:07:22.9 WO:** Yes. And that myth is very widely promulgated by President-elect Biden's new Asia policy coordinator, Kurt Campbell. He and Ely Ratner wrote an article in Foreign Affairs saying this. And as history, it's just completely false. At no point were the major decisions about engagement with China reliant on an assumption that China would become a democracy or a liberal Western-type society. Nixon engaged China as a balance for the Soviet Union. Then the administration that actually normalized relations with China was the Carter administration. As it happens, I was head of the Asia policy task force in the campaign, and we certainly never mentioned democratization or social liberalization.

**0:08:39.7 WO:** And Mike Oksenberg was the China guru in the administration, and he testified

very eloquently that United States has no capacity to change Chinese politics, and he wrote in Foreign Affairs about that. I know from personal first-hand knowledge that Brzezinski and Carter both shared that view. Then the WTO permanent trade relations or what was called most-favored-nation status at the time was the next big issue. And I was heavily involved in testifying for American business on that issue. And the business community, specifically the American Chamber of Commerce from Hong Kong, changed enough votes on economic grounds to make that effort to take away most-favored-nation status fail. And indeed, the argument at the time was not that engagement with China would bring liberalization, almost all the Democrats, including initially President Clinton, were arguing very strongly that allowing normal trade relations with China would encourage dictatorship.

**0:10:23.8 WO:** The next issue of engagement was WTO membership. I went back and I reviewed all the congressional testimony for both the MFN decision and the WTO decision, and I couldn't find any administration testimony that said that engagement would democratize China or lead to a much more liberal society. The closest was Larry Summers' testimony that it would facilitate better rule of law in China, and that actually happened. So all along the argument was that engagement would enhance peace and it would enhance prosperity. And that engagement was a complete success. We've had half a century of peace and the prosperity of the world has increased specifically because of US-China engagement, more than at any time in all of world history. So in both the Trump administration and the Biden administration, you have completely phony lines leading policy.

**0:11:51.3 LH:** And have you seen the State Department, the document that came out called The Elements of the China Challenge, that the policy planning staff came out? I wonder if that's going to be a blueprint for the Biden administration? Or, in other words, do you see a change occurring between the two administrations?

**0:12:15.6 WO:** I think there will be change. The Biden administration is going to take a much more professional approach. Trump's policy and Pompeo's were essentially policy by tweets, it was not coordinated, it was very heavily based on made-up stories. Vice President Pence led on China policy with an argument that China's major strategic initiative, the Belt and Road Initiative, was a conscious design to get third world countries deeply indebted and make them subordinate in foreign policy because of the debt. Every professional review of the situation has come to exactly the opposite conclusion, and he made up facts about a port in Sri Lanka that simply weren't true. That kind of stuff is not going to happen under Biden, and the other thing is that there will be a certain balance in the way Biden presents his policy.

**0:13:38.1 WO:** The Trump policy was defined by four speeches by Barr and Pompeo and Pence, and it was all demonization, everything was evil about China, and it created a McCarthyite atmosphere that has absolutely terrified Chinese in America and Chinese-Americans. That's not going to happen under Biden, but relations with China are going to remain very difficult and tough under Biden, that is not going to change, and that's because China has adopted policies in Xinjiang and Hong Kong and on economic and maritime issues that the US simply has to oppose.

**0:14:42.3 LH:** So yeah, so it's not going to be a Kumbaya moment.

**0:14:45.8 WO:** No.

**0:14:46.5 LH:** But certainly China, I can only imagine the confusion that must have been caused over the last four years in the Chinese bureaucracy, and then they themselves have lashed out, as you know, the Ministry of Foreign Affairs has adopted a very strident approach that's unprecedented as far as I know.

**0:15:07.7 WO:** What they call their wolf warrior approach of being very aggressive and unpleasant has proved very counter-productive for them, as Pompeo's diplomacy has proved counter-productive for the United States. So we're in an emotional spiral here that we need to break.

**0:15:35.8 LH:** Another part of that emotional spiral and the dialogue here in the United States about losing jobs to China, you say is a myth as well, that we can't really blame American job losses in manufacturing on China's ascent, and I think that's really worth exploring.

**0:15:58.5 WO:** This is absolutely crucial to the relationship. All the research has shown that first of all, the decline of manufacturing jobs is continuous since 1947. If you look at the curve of that decline, you can't even see where China comes in, and that's because most of the decline is caused by technological change. We can build cars now with very few worker hours, it's all done by the technology, the robots, the automation, and so about six out of seven manufacturing job losses are caused by automation, and one out of seven is caused by globalization, and of that one out of seven, China's is a substantial part. But what's happened is that both of our political parties have an interest in blaming all the job losses on China; for the Democrats, the manufacturing unions are very part of their political base, and the AFL-CIO is particularly close to Nancy Pelosi.

**0:17:39.0 WO:** So, there is a big problem that's very difficult to solve, and that's the decline of manufacturing employment because of automation. Manufacturing jobs are going the same way that agricultural jobs went. Once upon a time, 98% of Americans worked in agriculture, and now it's more like 2%. And that's not because Peru stole all our agricultural jobs, it's because they were automated. Now, solving that domestic problem is very difficult and expensive, so it's much easier for the Democrats to say, "Oh, it is all China's fault," and then they don't alienate their union base and they don't have to do anything about it.

**0:18:37.1 WO:** And on the Republican side, the Republicans never want to spend money or give power to the government for anything, and so they... They will never say, "Well, we should help these people in Akron, Ohio, when the factory goes down and all these people are just sitting around hopeless." They too, although less so, find it very convenient just to blame everything on China, and ironically, this creates the kind of social discontent, because all these people are in trouble, that supports Trumpism. So McConnell and Pelosi become the enablers of a kind of permanent anger against the establishment, which is what Trumpism is all about, and that means we're going to have another round of Trumpism in our future.

**0:19:47.0 LH:** Well, there are a lot of economic studies that have been done of these communities where manufacturing has shut down and the consequences are really severe, it's not just that somebody has lost their job, that person's health has deteriorated, and as we know now, white males, for the first time in history, their longevity is not lengthening, it's in fact shortening. So also the educational attainment and the health of their children is impacted, and so the whole community has an impact, but the issue is finding the cause of this and proper solutions is what you're saying. It's a problem, but not, maybe we've identified the wrong culprit.

**0:20:41.8 WO:** We've identified the wrong culprit, although there's no confusion among scholars about the cause, and that analysis of the cause has appeared in big articles in every major newspaper, so it's political gamesmanship, it's not real confusion about the cause, and we know the solution, the solution is to help people move into the services economy. All modern economies are services economies, and even China is... More than half of the jobs in China are in the services economy. In the 10 years when we lost three million manufacturing jobs, China lost about 45 million, but their politicians said, "Okay, we have to move people into the services economy," and they did. But what our politicians do, unfortunately, I'm a Democrat, but unfortunately, this is mostly Democrats, they deride services jobs as flipping burgers for McDonald's. Of course, all these politicians are in fact highly paid people in the services economy, so again, it's a huge hypocrisy.

**0:22:09.4 LH:** Right. [chuckle] And of course, Covid has really made this even a sharper divide too in terms of the kind of services that you can provide sitting in your home or doing what we're doing right now, and the one, and personal services like flipping those burgers where you are required to be outside your home. So it's made it more starkly apparent, I think, to people, but it's amazing how productivity and the gains in wealth haven't been... There's a huge inequality issue, which is also, by the way, shared in China, it's not just in the United States, the urban rural divide in China is quite stark as well.

**0:22:53.9 WO:** Yes, indeed.

**0:22:55.2 LH:** So that kind of leads me to the next myth about China being a super, Superman and a behemoth that is inexorably going to become bigger and better, and there's no way to block it or to change it economically, but you are saying... And China's GDP just came out over the weekend, and China does have a positive GDP, it looks like it's doing well, but it's mostly in investment in real estate, not, for example, in retail spending or the consumer area.

**0:23:31.6 WO:** China has done very well economically, but they are headed for a slowdown. Even the top Chinese economists acknowledge that in the 2030s, China will struggle to grow 3% a year, but what panics Americans is when China says in their manufacturing 2025 plan or their new five-year plan, we are going to dominate all the major manufacturing industries, and for some reason, our politicians believe it when the Chinese say it, that's what's going to happen. The same thing happened in the late '70s and the 1980s when Japan announced these industrial policies that were going to take over the world, and total panic in Washington.

**0:24:34.1 LH:** We are old enough to remember that. [chuckle]

**0:24:40.6 WO:** Yeah. And what happened in Japan, well, it turns out government subsidies and other things like that led to a few major successes, very expensive ones, and to many more very expensive failures, and that headed Japan towards stagnation. Somehow, when it's an Asian country, our politicians believe that industrial policy and highly managed economies are much more efficient than our market system. That's not what they preach at home. Now, China is going to have the same problems that Japan did. They have a lot more money for subsidies, but they're wasting it just the way Japan did. They've subsidized their chip industry to the tune of \$103 billion, and it keeps falling farther and farther behind. They've subsidized the airplane industry for \$45 billion, and they're nowhere near having a competitive airplane. Their car industry is dominated by Volkswagen and Buick and Hyundai. So if our politicians are afraid of China, maybe they should be very happy about these Chinese industrial policies and the focus on building up huge state-owned enterprises and seriously harming the private sector. They shouldn't be panicking about it.

**0:26:31.0 LH:** That's definitely a Xi Jinping departure, isn't it? Because before, the idea was private enterprise was going to be encouraged, but now it seems that that's being reversed, and we're back to SOEs again.

**0:26:47.8 WO:** The private sector is being under-financed; it's being controlled politically. Every company, private or state, has to have the final business decisions approved or made by the party committee, that means by politicians. Can you imagine what would happen to Apple if we put one of our politicians in charge of approving all final decisions? It would be a disaster. And it's not that different in China.

**0:27:22.3 LH:** Things aren't so copacetic in terms of that. [chuckle] And one thing that worries me is this growing tech divide: Having two Internets potentially, and also standards, I think would create a lot of inefficiencies, actually, for everybody. Another issue that you brought up was this myth that war with China is inevitable, so we should focus instead of on the business issues, we were just talking about, we should focus on building up the military. But you don't agree with that.

**0:28:00.0 WO:** No. Political scientists in this country are very focused on studying what happened in countries before World War II, and the latest is Graham Allison's book, *Destined for War*. And you survey all these situations where there was an established power and a rising power, and three out of four times that the two powers went to war. Now, there is a one out of four times where they didn't, and that's important. But the other thing is that the game has changed since World War II. Two things have changed: We've learned how to grow economies much faster, and the second is that if you do the growth of a great power the way it was done before World War II, the advances in military technology mean that war is so devastating that both sides are going to lose.

**0:29:13.4 WO:** And the way to become and remain a big power now has become mainly economic. So the US defeated the Soviet Union in the Cold War by having a very effective economic strategy for itself and its friends, whereas the Soviet Union put all its money into the military and went bust. So we won an economic victory, and that's how Germany became the dominant power in Europe, that's how Japan became a big power. In Korea, South Korea was inferior to North Korea in every

way, but then they switched from a military priority to an economic priority, and now the South Korean economy is 50 times larger than North Korea. It's clear who's won.

**0:30:12.5 LH:** And Japan not having a defense burden certainly helped Japan's economy.

**0:30:17.3 WO:** Yeah, and the same thing has happened with Indonesia, which is now the leader in Southeast Asia. And China's take-off started when Deng Xiaoping cut the military budget from 16% of the economy to 3% and settled 12 border disputes so that they could focus on economic growth. That made them a big power long before the current military buildup started. So economic strategy has become the key to success. That doesn't mean you don't need a strong military, you do, but the military strategy protects a strong economic strategy. What's happened, though, is that the US has forgotten the lessons of the Cold War, and it's been dismantling AID, dismantling US Information Service, cutting the State Department budget, and allowing institutions like the IMF and the World Bank and the WTO to atrophy, to lose relevance, whereas China has learned a historical lesson, and their Belt and Road program is just a recapitulation in Chinese style of the old US Bretton Woods system.

**0:31:57.6 WO:** You have development banks that lend for infrastructure, you have a drive to create common standards, you have a drive to liberalize trade and investment, all the things that the US has been pulling back on in order to focus our foreign policy on the military, China has been picking up. Now, that leaves the question, why is it... Why after having this huge success has the US pulled back? Well, what happens in peacetime is the Congress doesn't look for a coherent foreign policy strategy, it asks who's paying the bills for re-election? And the State Department and AID, and US Information Service and all of them, don't have big lobbies to pay for re-election campaigns.

**0:33:03.8 WO:** But the military has a huge lobby, tens and tens of billions of dollars. So they get the budget, and every administration through the Cold War, the State Department gets cut back, cut back, cut back. So we're not making as big a mistake as the Soviets did, but we're making a mistake that creates a huge opportunity for China, and China is taking that opportunity. But the lesson of a shift to an era where economic strategies are dominant, is that both sides can win. Again, we were terrified in the '70s and the '80s that Japan was going to take over the world. No, we ended up with better cars and the Japanese ended up with better products of all sorts of kinds from us. And both sides can win, you compete frantically. It's very serious competition, but it doesn't mean that it's rational to go to war.

**0:34:22.1 LH:** My father worked for USIA, and I remember... And I think this was under Clinton, when all the libraries around the world were closed, and I remember that they were packed, those libraries, with people learning of English and so forth, but I found out that the savings that year from closing all the libraries was only \$5 million. So that seems a very sad thing to me. But soft power... So what you're talking about is a combination of soft power and economic power and competition as the way forward.

**0:35:00.1 WO:** Yes. Absolutely.



**0:35:05.5 LH:** So if you were to think about a possible scenario, though, for a military conflict, how do you see Taiwan? Do you think that that situation could be a potential tinderbox for US-China relations, or is that just a lot of huffing and puffing?

**0:35:26.6 WO:** It's a potential and the potential for a big war has just gone through the roof because... We made a deal in 1972 with China that basically... There were compromises, they didn't get the sovereignty and control that they wanted, and we didn't get the independence that a good many Americans wanted, but what we got was the potential for a vigorous, prosperous democracy in Taiwan. And that was what we wanted. And what we didn't get was the right to have a full diplomatic relationship and to have a military alliance or to send our cabinet members back and forth to deal with Taiwan directly.

**0:36:40.5 WO:** And Pompeo has just blown that up. He said, we're not going to accept any of those constraints anymore. And there are even voices pushing for a close explicit military relationship with Taiwan. Well, pushing that too far, the Chinese will go to war. I've never met anyone in China who wouldn't support a war if we push toward completely treating Taiwan as an independent country. Now, the Chinese have been misbehaving, have been tougher on where they send their aircraft and ships around Taiwan, but they've stayed within the former limits of the deal. Pompeo has basically said, "We're breaking the deal." And so I have to say the risk of a real war has become much more serious.

**0:38:01.7 LH:** And South China Sea as well, which kind of also makes me think about how Xi Jinping has been a departure. And what you've said in your sixth and final myth is that China is always changing, and that's something that we need to understand. It wasn't that President Xi is doing what Deng Xiaoping intended, for example. In other words, they're moving targets and evolution within the Chinese government itself, and people don't see that is what you're saying.

**0:38:42.2 WO:** Yes, each generation in China changes dramatically. So, from Mao's vicious totalitarianism with a totally closed economy, Deng Xiaoping opens things up and gives people a lot more freedom, and Jiang Zemin continues that. But the market stresses with 45 million state enterprise workers, mostly in manufacturing, losing their job was just too much. Chinese society just got totally stressed out. So the next leader, Hu Jintao, said, "No more of these market reforms," and both market reform and political reform just stopped. Under him, the authority of the Central Government started to be challenged very severely. Ministers weren't listening to the prime minister, the local governments weren't listening to the central government, the civil society groups were becoming very outspoken. The generals were not focusing on how to shoot straight; they were focused on the next big real estate deal.

**0:40:09.2 WO:** And so, Xi Jinping was hired to bring this all under control, and he's certainly done that, but he's overdone it. And he's in a position kind of like President Trump, where he's got a mass support base and a much bigger mass support base, even proportionately, than Trump ever had, but he's got a very, very discontented elite, which thinks he's taking the country backwards. So eventually, there's going to be some kind of reaction against this. And China may get much worse or

it may get much better, but again, it will change. The mistake people make in foreign policy in Washington is... Particularly the really xenophobic types say, "Well, they always planned this kind of crackdown on Hong Kong." No, I was involved with all the leaders who were doing the planning for Hong Kong's autonomy and for implementing it, and they were totally sincere, and they were shocked... They would be shocked at what Xi Jinping has done. And if they could do anything about it, they would intervene and stop it. There will be a reaction. Xi Jinping is in a very difficult position, having alienated most of his own elite.

**0:41:52.6 WO:** So, we shouldn't base our relationship with China on the assumption that this kind of increasing repression at home and aggressiveness abroad are eternal. Maybe they will be, but this is not something that was planned from decades ago and it was always going to be implemented.

**0:42:23.1 LH:** I really loved it the last paragraph of your article, I love this, this one sentence, "The next version of China will be either much better or much worse. America must be prepared for either." And I'm wondering what you think about US businesses in China. What do you think they can expect over this next four years, now?

**0:42:48.1 WO:** Well, the role of American businesses has evolved tremendously over time. In the early days, business was treated very well, enormous market, and much more open than Japan and South Korea, for instance. General Motors sells 2.9 million cars in China, and that's saved General Motors from bankruptcy and dissolution. The comparable number of car sales in Japan is 1000; 2.9 million versus 1000. And the business community occupied itself with explaining China to Congress, and then more recently, business found itself so restricted in terms of market share that it's fundamentally crippled. For instance, why was Huawei in a position to take over the world of 5G? Huawei has access to the European market, the US market, and the Chinese market, which happens to be the biggest one... Or it did. And Ericsson and Nokia, which were the big global competitors, only have access to the European, American, and a very small part of the Chinese market.

**0:44:29.7 WO:** Huawei could have an R&D budget much bigger than Nokia and Ericsson combined. It was just going to slaughter them. And that's the story of the current relationship in China. They're no longer developing a country that can wall itself off and not have big consequences for the rest of the world. Those consequences can be absolutely devastating. And so American business demanded that Washington do something, but the Trump administration did all the wrong things. Business wanted the problems solved. They didn't want the problems intensified to such a degree that they become unsolvable. And right now, we're in a spiral. The risks making these problems, even somebody with the best of intentions to exit this spiral, where do you draw the boundary in saying, "Well, any business with military connections, we're going to sanction."

**0:45:51.9 WO:** They've said all the telephone companies have to be sanctioned because they have some connection with the military. Well, by that kind of standard we shouldn't be doing business with virtually anybody in China. How do we get out of that spiral? So things are going to get worse and worse for American business in market share terms, but still, it's a huge market that they can't afford to give up. So, this is going to be the great conflict of the next decade, really. If Biden tries to

right the balance the Republicans are going to accuse him of being soft on China.

**0:46:43.4 LH:** So are you working on a new book I hear? Can you tell us anything about it?

**0:46:48.0 WO:** I'm working on publications about Sino-American relations. And the big long-term project is about democracy and dictatorship as they affect economic development, and there I'm looking at the Philippines, and South Korea, and China, and India, and Thailand, and Japan. The basic conclusion of that project is that in certain kinds of situations democracy is ideal, but in many kinds of third world situations, it actually entrenches a rapacious elite. And so we need to be a little more humble about the idea of democracy being, our kind of democracy being the perfect kind of system for every culture, in every country, at every level of development. And we need to start thinking about what kinds of variations of democracy would offset some of these problems that a place like the Philippines or India has. But that project's a ways off.

**0:48:26.2 LH:** How can we find all of your writing in one place? What is your website, or Twitter handle?

**0:48:32.9 WO:** I have a website called [theoverholtgroup.com](http://theoverholtgroup.com) and on that, if people go to Publications then there's a list of publications on each of many countries. It goes back to the 1970s.

**0:48:51.5 LH:** That's wonderful. Thank you, Bill, so much for joining us today. This is Lyric Hughes Hale, Editor-in-Chief of EconVue, and we've been joined in our podcast by Dr. William Overholt, who is a Senior Fellow at the Harvard Kennedy School of Business, and we've been talking about US-China relations. And I think that probably all of us, including people who've spent a lot of time in China, have learned a lot today. Thank you so much.

**0:49:23.3 WO:** Thank you.

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