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CAN XI END CHINA'S GLIDED AGE? (Project Syndicate – Sept 21, 2021)



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The period after America's late-nineteenth century Gilded Age laid the domestic foundation for the country's international primacy in the twentieth century. Likewise, China's global prospects will depend on whether President Xi Jinping can lead the country into its own era of progressive reform.

ANN ARBOR - Within the span of a generation, a new super-rich class emerges from a society in which millions of rural migrants toiled away in factories for a pittance. Bribery becomes the most common mode of influence in politics. Opportunists speculate recklessly in land and real estate. Financial risks simmer as local governments borrow to finance railways and other large infrastructure projects. And all of this is happening in the world's most promising emerging market and rising global power.

No, this is not a description of contemporary China, but rather of the United States during the Gilded Age (roughly 1870 to 1900). This formative period of American capitalism is remembered as "Gilded," rather than "Golden," because beneath the veneer of rapid industrialization and economic growth, many problems festered.

Public backlashes against the Gilded Age triggered wide-ranging economic and social reforms that ushered in the Progressive Era (approximately 1890s-1920s). This domestic revolution, along with imperial acquisitions abroad, paved the way for America's rise as the superpower of the twentieth century.

China is currently passing through a similar - though certainly not identical - phase. After coming to power in 2012 during China's own Gilded Age, President Xi Jinping now presides over a country that is far wealthier than the one ruled by his predecessors. But Xi also must confront a host of problems that come with a middle-income, crony-capitalist economy, not least corruption. As he warned in his maiden speech to the Politburo in 2012, corruption "will inevitably doom the Party and the state."

Over the past few decades, China's economy has soared alongside a particular type of venality: elite exchanges of power and wealth, or what I term "access money." Beginning in the 2000s, the incidence of embezzlement and petty extortion fell as the government built up its monitoring capacity and enthusiastically welcomed investors. But high-stakes graft exploded as politically connected capitalists plied politicians with lavish bribes in exchange for lucrative privileges.

Along with cronyism came rising inequality. Since the 1980s, income inequality has risen faster in China than in the US. China's Gini coefficient (a standard measure of income inequality) exceeded America's in 2012. And Chinese wealth inequality is even wider than income inequality, because those who accumulated assets during the early growth stages realized enormous gains.

A third problem is systemic financial risks. In 2020, the finance ministry warned that local governmental debt was approaching 100% of all revenues combined. If local governments default, the banks and financial institutions that loaned them massive sums will be exposed, potentially setting off a chain reaction. And it is not just government finances that are in trouble. China's second-largest property developer, Evergrande, is \$300 billion in debt and nearing insolvency.

These simmering crises should not be viewed in isolation; rather, they are interconnected parts of China's Gilded Age. Corruption in the form of access money spurred government officials to promote construction and investment aggressively, regardless of whether it was sustainable. Luxury properties that enriched colluding state and business elites have mushroomed across the country, while affordable housing remains in short supply. Those with political connections and wealth have easily reaped outsize profits through speculative investment.

Likewise, in the digital economy, what was once a free-for-all arena has consolidated around a few titans that

can easily crush smaller players. Factory workers are being replaced by gig workers who toil long hours with scant labor protections. Fed up with excessive materialism and the rat race in society, young people are protesting by “lying flat” (ceasing to strive).

The decadence of China’s Gilded Age poses multiple threats for Xi. Corruption, inequality, and financial meltdowns can trigger social unrest and erode the legitimacy of the Communist Party of China, given its promise of equality and justice. These problems – particularly elite corruption, which enriches rival factions – all undermine Xi’s personal hold on power.

Thus, Xi is determined to take China out of its Gilded Age, both to save the CPC and to cement his own legacy as the leader who will deliver the Party’s “original mission.” Whereas Deng Xiaoping aspired to make China rich, Xi wants to make China clean and fair as well.

In the last two months, Western investors have abruptly awoken to Xi’s calls for “common prosperity.” But Xi’s socialist mission actually began in 2012, when he vowed to eliminate rural poverty and simultaneously launched the largest anti-corruption drive in the CPC’s history. Xi has maintained these campaigns despite the pandemic, and he proudly proclaimed in 2020 that his poverty alleviation targets were achieved on schedule.

More recently, these campaigns have extended into a wave of regulatory crackdowns on Big Tech companies, bans on private tutoring, caps on housing prices, and a clampdown on rich celebrities. To top it off, Xi has personally exhorted the rich to share their wealth with society.

America’s Gilded Age provides a historical lens for making sense of Xi’s actions. All crony-capitalist economies, no matter how fast-growing, eventually run into limits. If American history is any guide, the problems facing China today do not necessarily spell doom. Much depends on what policymakers do next. If the problems are tackled appropriately, China, too, can move from risky, unbalanced growth to higher-quality development.

But whereas the American Progressive Era relied on democratic measures to fight crony capitalism – for example, through political activism and a “muckraking” free press that exposed corruption – Xi is attempting to summon China’s own Progressive Era through command and control. The world has yet to witness a government successfully overcome the side effects of capitalism by decree.

Decades earlier, Mao Zedong tried to command rapid industrialization and failed disastrously. The lesson is that because top-down orders can and do backfire, they must not be relied upon as the solution to all problems. If excessively and arbitrarily applied, bans and edicts will diminish investor confidence in Chinese leaders’ commitment to rules-based markets.

Progressivism in America laid the domestic foundation for the country’s international primacy in the twentieth century. Whether Xi can order China out of the Gilded Age will determine the continuity of China’s rise in the twenty-first.

TAMING THE STAGFLATION WINDS (Project Syndicate – Sept 22, 2021)



Mohamed A. El-Erian, President of Queens’ College, University of Cambridge, former chairman of US President Barack Obama’s *Global Development Council* and author

Rising inflation and declining growth are more likely to be a part of the global economy’s upcoming journey than features of its destination. But how policymakers navigate this journey will have major implications for longer-term economic well-being, social cohesion, and financial stability.

CAMBRIDGE – A stream of recent data suggests that the global economy is showing signs of stagflation, that odd 1970s-style mixture of rising inflation and declining growth. Those who have noticed it – and there are still too few of them – fall into two broad camps. Some see the phenomenon as temporary, and quickly reversible. Others fear that it will lead to a renewed period of unsatisfactory growth, but this time with unsettlingly high inflation.

But a third scenario, which draws on both of these views, may well be the most plausible. Stagflationary winds are more likely to be a part of the global economy's upcoming journey than a feature of its destination. But how policymakers navigate this journey will have major implications for longer-term economic well-being, social cohesion, and financial stability.

The much-needed global economic recovery has recently been losing steam as growth in its two major locomotives, China and the United States, has undershot consensus expectations. The more contagious Delta variant of the coronavirus has dampened spending in some sectors, such as leisure and transportation, while hampering production and shipments in others, particularly manufacturing. Labor shortages are becoming more widespread in a growing number of advanced economies. Add to that a shipping-container shortage and the ongoing reordering of supply chains, and it should come as no surprise that the headwinds to a strong and sustainable global recovery are being accompanied by higher and more persistent inflation.

Higher inflation is putting pressure on those central banks that wish to maintain an exceptionally loose monetary policy. At the same time, decelerating economic growth presents a problem for central banks that are more inclined to scale back stimulus measures. All this also risks eroding political support for much-needed fiscal and structural policies to boost productivity and long-term growth potential.

Some economists, and the majority of policymakers, believe that current stagflationary trends will soon be muted by a combination of market forces and changes in human behavior. They point to recent declines in previously spiking lumber prices as indicative of how competition and increased supply will dampen inflation. They think the sharp fall in Delta-variant cases in the United Kingdom foreshadows what lies ahead for the US and other countries still in the grips of the latest COVID-19 wave. And they take comfort from multiplying signs of booming corporate investment in response to supply disruptions.

Others are more pessimistic. They argue that demand headwinds will intensify due to reductions in fiscal schemes that were supporting household income, citing the expiration of supplementary unemployment benefits and direct cash transfers. They also worry about the gradual exhaustion of the cash buffers that many households unexpectedly accumulated as a result of exceptionally generous government support during the pandemic.

On the supply side, the stagflation pessimists welcome higher business investment but fear that its benefits won't come fast enough, especially as supply chains are redirected. Supply disruptions will therefore persist for much longer, in their view, and central banks will fall behind with the needed policy response.

I suspect that neither of these scenarios is likely to dominate the period ahead. But they will influence the alternative that does materialize.

Ideally, policymakers would respond in a timely and self-reinforcing manner to the increasing evidence of stagflation. The US would lead by progressing faster on a policy pivot, with the Federal Reserve already unwinding some of its ultra-loose monetary policy and Congress enabling President Joe Biden's administration to advance its plans to enhance US productivity and longer-term growth by boosting investments in physical and human infrastructure. Meanwhile, national and international financial authorities would coordinate better to strengthen prudential regulation, especially as it pertains to excessive risk-taking among non-bank market participants.

These measures would lead to declining inflationary pressures, faster and more inclusive growth, and genuine financial stability. And such a desirable outcome is attainable provided the needed policy response proceeds in a comprehensive and timely manner.

Absent such a response, supply-side problems will become more structural in nature, and therefore more prolonged than the transitory camp expects. The resulting inflationary pressures will be amplified by the higher wages that many firms will have to offer to attract the workers they currently lack and retain the ones they have. With central banks lagging in their policy response, inflationary expectations risk being destabilized, directly undermining the low-volatility paradigm that has helped push financial-asset prices ever higher.

Because the Fed would then be forced to hit the policy brakes, higher inflation would be unlikely to persist. Unfortunately, reducing it would come at the cost of lower and less inclusive growth, especially if the Biden administration's plans remain stuck in Congress (which would be more likely in the high-inflation scenario). Rather than prolonged stagflation, the global economy would repeat what it experienced in the aftermath of the 2008 global financial crisis: low growth and low inflation.

The recent appearance of stagflationary tendencies serves as a timely reminder of the urgent need for comprehensive economic-policy measures. The faster such a response materializes, the greater the probability of anchoring economic recovery, social well-being, and financial stability. But if policymakers delay, the global economy will neither be saved by self-correcting forces nor pushed into a prolonged stagflationary trap. Instead, the world will return to the previous “new normal” of economic underperformance, stressed social cohesion, and destabilizing financial volatility.

THE REAL RISKS OF AUSTRALIA'S SUBMARINE DEAL (Project Syndicate – Sept 22, 2021)



Gareth Evans, former foreign minister of Australia, President Emeritus of International Crisis Group, Co-Chair of International Commission on Nuclear Non-Proliferation & Disarmament, honorary professor at Australian National University and author

The new AUKUS agreement does not mean, as some Australian commentators have asserted, that the country has now finally “taken sides” against China. Australia's primary security relationship is with the US, and its primary economic relationship is with China - and there is no reason to change that now.

MELBOURNE - Some world-class hyperbole has been generated by Australia's new AUKUS technology-sharing agreement with the United States and the United Kingdom. Our proposed acquisition, in particular, of at least eight nuclear-powered submarines, voiding in the process a massive deal with France to build 12 conventionally propelled diesel submarines, has fueled an uproar at home and abroad.

For some in the anti-nuclear movement, the AUKUS agreement poses the biggest threat to nuclear non-proliferation since North Korea's breakout. For Australia's Greens, “floating Chernobyls” are about to blow up our port cities. For anti-China hawks, it's champagne time: AUKUS represents a “vital bulwark against an angry and authoritarian communist China.” For China's foreign ministry, it “seriously damages regional peace and stability, intensifies the arms race, and undermines the Non-Proliferation Treaty,” and, for China's media wolf warriors, it makes Australia “a potential nuclear war target.” For France, which withdrew its ambassadors from the US and Australia, it's another brutal “stab in the back” from perfidious Albion and the Anglosphere. And for Australia - in the words of two former prime ministers, no less, which should certainly concentrate our minds - it may mean a “further dramatic loss of sovereignty” to the US and “a slippery slope” that ends in “a pre-commitment to becoming an active belligerent against China in a future war.”

It is time to take a breath and focus on what is perfectly defensible about the AUKUS agreement, what is problematic, and what demands further clarification before it can be accepted. There are both technical and political risk issues involved, and it is important to keep them disentangled.

The starting point must be that it is clearly defensible for Australia, like any country, to prepare for all plausible threat contingencies that might conceivably emerge in the decades ahead, and in doing so get the biggest possible bang for its defense buck. We are an island continent with a massive coastline to defend - at least in the north - against threats that, however unlikely now, could arise in the future, as they did in the past with the bombing of Darwin in World War II. In an age where surface vessels are ever more vulnerable to missile attack, it is almost universally accepted that highly capable submarines must be an indispensable part of our arsenal.

CHOOSING THE RIGHT MODEL

Technically, a strong case can be made that the submarines most fit for Australia's purposes are, and always have been, nuclear rather than conventionally propelled. They are much faster in getting to station, and away from trouble; they can remain underwater for periods limited essentially only by crew endurance. And with the latest technology, they are said to be more silent as well (although some contest this, because they can never turn off their reactors' cooling pumps).

Some respected analysts, like Hugh White, an emeritus professor at the Australian National University and former senior defense official, argue that Australia would be better off overall with a much larger number of

smaller, quieter, and more maneuverable conventionally powered submarines with more limited range. Such views are in a minority among specialists, but should be exhaustively tested before Australia becomes finally and irrevocably committed to going nuclear. The public should demand to be told whether all options have been vetted, or will be, and with what result.

In an Australian context, the huge distances involved in traveling from any home port to potential maritime trouble spots in our northern archipelago and beyond do clearly mean a great advantage for nuclear-propelled submarines. It has been estimated that, operating out of Perth, our six Swedish-designed Collins-class boats, deploying for a maximum of around 50 days, could spend only 11 days on station as far away as the South China Sea, whereas a nuclear-powered boat could stay there many times as long. Some will argue that this capacity to patrol such sensitive locations is inherently more provocative than anything the Australian navy might currently be doing. But no power in our region is naive enough to believe that our current submarines, in the 25 years we have had them, and limited in range and endurance though they may be, have spent all their sea-time circumnavigating Tasmania. Any operational change will be in degree, not in kind.

PROLIFERATION AND SAFETY RISK?

Claims that nuclear-propelled submarines are both a proliferation and safety risk have been absurdly overstated. There is no public support for acquiring nuclear weapons of our own, and all Australian political parties have ruled it out as unconscionable. The same is true of producing our own fissile material. There is a conceivable diversion risk when naval reactors need refueling, but Prime Minister Scott Morrison has already said – and he needs to be held to this formally before any deal is finally concluded – that “next generation nuclear-powered submarines will use reactors that do not need refueling during the life of the boat.” He was no doubt pointing to the fact that naval reactors fueled with highly enriched uranium can indeed operate, as extraordinary as this sounds to the layperson, for 30 years with no new fuel (and with access to their existing fuel physically sealed). Their low-enriched-uranium counterparts, including French boats, need two or more new cores during their lifetime, providing a plausible diversion path.

Some argue that Australia will need to build major new civilian nuclear infrastructure to support the AUKUS boats, and that this will necessarily tempt us down various nuclear fuel-cycle paths, with all the associated proliferation and safety issues. But if lifetime-fueled sealed naval reactors are used, as they should be, with no fissile material domestically produced or even handled, the required supporting nuclear capacity will be minimal. We will certainly need a significant number of fully trained and qualified specialists to operate and monitor these reactors, but that will be readily achievable in the long lead-time available, and carries with it no larger implications. The sealed-unit reactors themselves require no technical maintenance, and with their excellent reliability and safety record are unlikely to generate problems of the kind that would require US or UK attention. Building a facility ourselves to cope with remote contingencies of this kind would not make much sense.

There is a remaining proliferation issue to be addressed: The International Atomic Energy Agency has not yet developed (as it should) oversighting arrangements for naval propulsion programs. Some question whether the AUKUS deal will create a discomfiting precedent for the US in meeting demands for nuclear submarines from other allies, in particular South Korea, to which the US has so far been reluctant to agree. But provided that, like Australia, such a recipient is in good non-proliferation standing, forswears domestic enrichment, and receives only reactors with a built-in lifetime fuel supply, it is difficult to see any proliferation-related reason for refusal, certainly in the case of South Korea.

As for safety, the “Chernobyl” claim is nonsensical. There has not been a single US reactor accident in 50 years of operating hundreds of boats across millions of sea miles. Moreover, naval reactors are only a fraction of the size of civil energy reactors, and are usually shut down in port, with a worst-case potential radiation release of less than 1% of a typical commercial reactor. Maybe it is time for New Zealand, while making no other concessions to its resolute nuclear-free status, to at least consider relaxing its blanket ban on visits from nuclear-propelled vessels.

In addition to these technical risk issues, the AUKUS agreement does entail what can be broadly described as political risks. There are the implications of the fall-out with France; the regional impact of a significant Australian capability upgrade; the crucial question of whether these significant new ties with the US will necessarily come at the expense of our independence; and whether the whole enterprise will serve only to make relations with China much worse than they would otherwise be.

BREAKING WITH FRANCE

Although the government had until now denied that the five-year-old deal with the French Naval Group to supply 12 redesigned Barracuda submarines was in serious trouble, the writing was on the wall for some time. Arguably misconceived from the outset, the contract's cost had already soared from \$A50 billion (\$36 billion) to an eye-watering \$A90 billion, delivery timelines were being missed, and expectations about domestic job creation were clearly not being met, all with little evident French contrition. The Morrison government has not said whether it ever considered going back to the original nuclear-propelled design of these boats, as a way of better meeting both operational and cost requirements. That needs to be explained before the final cost of extricating Australia from its contractual obligations - in addition to the \$A2.4 billion already now mostly wasted - is determined.

A good reason for not returning to the original Barracuda nuclear-propelled design probably lies in its refueling requirement, with all the above-noted proliferation and safety issues this raises. But there is no good answer to the charge of mishandling the breakup, which the US reportedly left for Australia to manage. This has not only generated French outrage - not all of it synthetic - but also clearly put at risk Australia's interests in a strong future partnership in the Indo-Pacific, not to mention EU trade deals. Of course, managing the sequence of communications was always going to be a delicate and difficult task, but that's what competent diplomacy is all about. Having a chronically invisible foreign minister, and a newly appointed head of her department with no previous diplomatic experience, cannot have helped.

REGIONAL ANXIETY

The anxious initial response from Indonesia and Malaysia to the AUKUS announcement - with Malaysian Prime Minister Ismail Sabri Yaakob saying that it would be a "catalyst for a nuclear arms race in the Indo-Pacific region" - also suggests an absence of effective diplomatic preparation by Australia. Morrison's government evidently failed to explain both the negligible proliferation risks of the new deal and the military legitimacy of Australia improving, with a very long lead time, its capability to handle future threat contingencies.

Australia's storytelling task was probably not helped by the Anglospheric character of our new three-way partnership. We have been claiming for years to be Asia-focused and committed to the region, and Labor governments, at least, have said (and believed) that our future depends on our geography rather than our history. In our neighborhood, a triumphalist new link-up of Australia with not only the US but the UK was always bound to jangle nerves. The only consolation is that, whatever is said publicly by the region's leaders, there is bound to be some private appreciation of any development which is likely to help concentrate Chinese policymakers' minds about the pushback they will likely face if China continues to over-reach in Southeast Asia.

AN AMERICAN TRAP?

It is reasonable for Australians to be concerned about the risks of becoming so closely enmeshed with the US in security matters that we lose all effective capacity for independent judgment and action. We have too often, above all in Vietnam and Iraq in 2003, joined the US in fighting wars that were justified neither by international law nor morality, but because the Americans wanted us to, or we thought they wanted us to, or we wanted them to want us to. It is simply naive to believe that the terms of the ANZUS treaty, all those past down-payments in blood, or a "century of mateship," mean that the US will be there for us militarily in any circumstance where it does not also see its own immediate interests being under threat. Going to war must always be a matter of considered national judgment, not blind loyalty to what Morrison now calls a "forever partnership"- or because it is the price of acquiring technology we need for our own defense.

The AUKUS agreement will unquestionably bind us even closer than we have been in security terms to the US, not just owing to its submarine component, but also in terms of the other highly sophisticated technology - including artificial intelligence, quantum computing, and missile-related systems - that also seems to be on offer. But, having said that, it needs to be frankly acknowledged that the principal benefit Australia has always derived from the US alliance is access to advanced technology and intelligence, otherwise beyond our reach. The new arrangement again represents a difference in degree, not in kind. Similarly, the UK's involvement is a function not only of its Astute-class submarines being, along with the US Virginia-class boats, one of the two obvious models for us to acquire, but also of decades of close engagement, especially through the Five Eyes intelligence agreement.

The bottom line is that Australia's political leaders in the years ahead must be unwavering in holding the Americans to their clear assurances by the US Secretaries of State and Defense, that the AUKUS deal will involve

“no follow-on reciprocal requirements of any kind,” and “no quid pro quo.” We are a sovereign nation-state, and must behave like it. Every future contingency, and every future request for our military involvement, must be addressed solely on its own merits. We win no respect or credibility anywhere by being anyone’s “deputy sheriff.”

AUSTRALIA’S CHINA QUESTION

It was inevitable that the AUKUS agreement, despite the care with which the “C” word was avoided in its announcement, would be almost universally portrayed as a response to China’s rise and new strategic assertiveness. The Morrison government’s repeated references to a changed and uncertain regional environment have done nothing but reinforce that interpretation. From one point of view, it is not bad that China gets the message - as it no doubt also has from the emergence of the Quad grouping, bringing together the US, Japan, Australia, and India - that there is an evolving will among other significant regional players to build stronger defense capability and cooperation.

But it is also critical to avoid over-reacting to recent Chinese behavior in the South China Sea and elsewhere, as problematic as some of it has been. And China should not be seen as some kind of existential threat to other sovereign states in the region; it is not one now and may never begin to be one. It may pose a challenge to America’s hitherto undisputed primacy in the region, and maybe ultimately in the wider world, but that is a different story. So is the particular issue of Taiwan, which of course remains troubling. But to assume the inevitability of violent conflict, hands poised above war drums, is stupidly counterproductive, running a real risk of becoming self-fulfilling.

The proposed AUKUS submarine and other defense technology programs should be seen - and sold - as being designed, like every intelligent procurement, to improve Australia’s capability to respond to future threats from anywhere in the region, rather than based on any state’s assumed hostile intent. It involves just a new layer of alliance cooperation, not a quantum shift. The announcement was bound to generate a negative Chinese reaction, and certainly will not help in the short run to improve our currently fraught bilateral relationship, which has a number of causes, some at least of Australia’s own making. But it will come as no great surprise to China, which has always assumed a firm and unchallengeable Australia-US security relationship, and will not inhibit China’s willingness to deal with us in other areas - such as iron ore purchases - if doing so is in its own interest.

The AUKUS agreement does not mean, as some commentators have breathlessly asserted, that we have now finally “taken sides” against China. Having our primary security relationship with the US and our primary economic relationship with China is the position which has clearly evolved for Australia in recent years, just as it has for quite a number of our Asian neighbors. There is no reason for us to change that now, or for the AUKUS agreement to be seen as having done so.

KEEPING OUR BALANCE

For me, Australia’s future security depends on us being honest about both the strengths and limitations of our traditional strategic dependence on the US, balancing appreciation with strong independent judgement. It means being much more genuinely self-reliant, which will require spending more than our traditional 2% of GDP on defense. It means being clear-sighted and balanced in our approach to China, accepting the legitimacy of some of its ambitions but being prepared to push back against others. It means being much more actively engaged in defense terms not just with the US but with other key Asian players like Japan, India, South Korea, Indonesia, and Vietnam, which can make an important collective contribution to maintaining regional peace and stability. And it means enhancing our general credibility by becoming more committed than we have been in recent years to helping to overcome collective-action problems in supplying global and regional public goods.

Nothing in the AUKUS agreement is inherently inconsistent with this approach, and there is much that the deal will assist, not least Australia’s strategic self-reliance. Nor, properly understood and implemented, is there anything in the agreement that should generate enduring hostility or anxiety from any other player in the region. The agreement has its risks, but none that cannot be countered by intelligent political leadership. That commodity has not been in abundant supply recently, but we live in hope.