2018 US-China Forum — The Trillion Dollar Question: What are the Goals of China’s Belt and Road Initiative?
So that was fantastic to hear two people who were in China so early at the opening and to discuss what it was like the time and to watch the evolution of the Chinese economy. It was really a privilege and fantastic-- so a good start to this conference. This next panel is the trillion dollar question. What are the goals of China’s Belt and Road Initiative? And what’s great about this particular panel is that we have a historian, a political scientist, and also an economist. So it’ll be a real cross-section of intellectual viewpoints to discuss this, and we'll probably broaden it out a little bit because there are so many issues that have already been raised so far this morning.

Let me tell you who’s on stage. Ken Pomeranz is there at the end. He’s the university professor of modern Chinese history and in the college University of Chicago. Good to have you here. Austan Goolsbee is the Robert P Gwinn professor of economics, Booth School of Business, University of Chicago, frequent guest on CNBC. Austan and I have known each other a long time. Dali Yang is William Claude Reavis professor in the Department of Political Science, University of Chicago.

So let's get started. I want to start with the historian. Can I call you Ken? Is that all right?

KENNETH POMERANZ: Of course.

MICHELLE CARUSO-CABRERA: All right. What precedent is there in China, if at all, for the Belt and Road Initiative, which is this planned, huge expenditure-- some estimates, a trillion dollars, in more than 60 countries for infrastructure. Have they ever done anything like this?

KENNETH POMERANZ: The closest thing to a precedent would probably be the Develop the West Project, the west meaning Western China, not the West.

MICHELLE CARUSO-CABRERA: Not us.

KENNETH POMERANZ: Right. And it's somewhat similar in that it was and still is a plan to move an enormous amount of capital into relatively poor places and try very quickly to bring them up to a higher level of development. Also similar in that it had this ambiguity of it was clearly a poverty reduction
program on the one hand, but it was also a program for making sure that eastern China got access to the resources of western China. And there were people in Western China who were not entirely thrilled about the way that that was working out.

**MICHELLE CARUSO-CABRERA:** You're talking about coal--

**KENNETH POMERANZ:** Coal, oil, natural gas, all sorts of things, hydro now as well. So there were suspicions, even domestically, about this, and it's also somewhat similar in that it was basically an economic initiative but one with complicated security implications very broadly speaking.

If you sort of think back, there were two ways that Chinese regimes, going back a very long time, had had of dealing with the part of the country that borders on in Asia. One philosophy was more or less, if you want stability, don't change things too much. The other philosophy was, no, no, if you want people to be happy, make them rich, even if the change is uncomfortable in the short run. And you'd seen over a very long time in China back and forth between those two positions.

The Develop the West Initiative was clearly a sort of final decision in favor of the developmental position, and you're seeing some of these same issues come up as China invests in places like Central Asia. Promise obviously is the hope that development will mean stability, but there are lots and lots of bumps in that road, lots of questions about the political regimes they're dealing with in doing it and so on.

**MICHELLE CARUSO-CABRERA:** I forgot to mention. They're walking around with cards. There's lots of people in the audience. We're going to go about a half an hour here and then take questions from the audience. So fill out the cards and then they're going to bring them up to me on stage.

Quick follow up-- a lot of people compare to the Marshall Plan that the United States with western Europe after the war. Is it comparable?

**KENNETH POMERANZ:** In most ways, I would say no. I mean, in part just the sheer scale is so much bigger. The one way-- if you wanted to do a thought experiment, remember that the Marshall Plan was originally proposed not just for Western Europe, but for all of Europe, including the Soviet Union. Had that been accepted, then you would have been dealing with a much wider variety of regimes, both for better and for worse.
And I think that might have— you also would presumably have to put a good deal more capital in. That might have been something closer to this. But I think, since that didn’t happen, the Marshall Plan actually isn’t that close a precedent.

MICHELLE CARUSO-CABRERA: Dali, the Belt and Road Initiative has seemed to have taken on political overtones. At least we perceive here in the United States to have taken on political overtones. Has it? Was that the original intention? Is that the current intention?

DALI YANG: Well, that’s a great question. In fact, Secretary Paulson was mentioning the massive stimulus that China unleashed during the great financial crisis. But the originally actually-- the Belt and Road Initiative was announced around 2013. So if you link the two actually, they really follow each other.

With the massive stimulus domestically, China dramatically increased capacity for production, and then we had to do something about it. And what did we do? They were thinking suddenly China was actually awash with production capacity, but the domestic market wasn’t enough actually. Because in that context and during a short visit actually to Kazakhstan that President Xi mentioned-- oh, maybe we can emulate or think back to the Silk Road of the Tang Dynasty to begin to develop something along the lines of the 21st century Silk Road. And then the maritime side was actually added.

So you see, in that context of helping countries in the West and also actually to the maritime side that the program was put together, there was no master plan in the beginning. [?] had this initial idea of developing this, but what happened however is this certainly would help China’s Western region as well because this program would have to go through the West certainly.

But at the same time, it would help China deal with the surplus capacity domestically. So it’s much more economic than strategic. There is a little problem. Because for Western strategists, however, immediately very soon they began to look to the past.

And what is in the past? And the past was actually two strategies-- one British, Halford Mackinder, who came up with the heartland theory. The other one was Alfred Mahan in the US who came up with the idea of sea power. And China was pushing both on land and to the sea. So in that sense actually, the Westerners began to see a much clearer strategy than the Chinese originally planned.
In fact, in recent years, the Chinese government has been backpedaling saying that, oh, no, no, we really didn’t have that strategy. But to the Western strategists however, it’s very easy to understand that there was a strategy.

MICHELLE CARUSO-CABRERA: Is it working?

DALI YANG: Well, when the program is driven by foreign reserves, when China had $4 trillion in foreign exchange reserves, it was much easier to do such a program because you can go out to Pakistan with the China Pakistan economic corridor or to Kazakhstan where PetroChina has taken a stake and so on and do it. And companies rushed onto the bandwagon.

But when the Chinese foreign reserves are down to $3 trillion, then suddenly it becomes much harder, especially because companies in China are being told you shouldn’t be spending so much foreign exchange now abroad. If that isn’t allowed, then it’s much harder for China to push this initiative with the vigor that it was doing actually a few years ago.

MICHELLE CARUSO-CABRERA: Austan, you’re the economist. What do you think of this big government spending program?

AUSTAN GOOLSBEE: Well, I think that the analogy that Ken made to Develop the West program is worth remembering. Mostly the Develop the West program didn’t work for what they wanted to do. The investment, it was explicitly-- let’s call it-- command and control driven, trying to keep the economic opportunities better in the west to prevent a lot of massive internal migration. And they haven’t totally succeeded.

MICHELLE CARUSO-CABRERA: Because they’ve got lots of migration.

AUSTAN GOOLSBEE: Because they still have lots migration, because there’s so many economic opportunities all along the east coast. I don’t know that-- it’s interesting to ask was it a strategy or did it just evolve from a out of stimulus-- maybe let’s call it. I think China’s going to find out the reason why, even at the height of the Cold War, the US in developing infrastructure and doing lending for big infrastructure projects in emerging market countries largely sent that to the World Bank
and was not actively doing that individually because, A, there’s shady operations, there are lots of uncertainties, things go terribly wrong, and the person who you owe the money to often is not very popular with the people who got the money.

So when the economy goes south and they say but we owe $50 billion to the United States for building this dam that it didn’t work and now the power’s not-- then they go, oh, we’ve got to burn the American flag. So the US said, you know what, let’s get out of that business. And so I wonder if, in all of this, China’s going to learn some of the lessons that the superpowers learned as it was going along.

And piled on with the second thing that-- for lending, there’s competition. It’s a competitive market. And if you want to fund big infrastructure projects, you could go out on the open market. If you can’t get that money, you could go to the World Bank. AS could try to get the loan.

Now there is a third entity, let's call it. If you were not able to succeed in the first two entities, I'd worry that these might be only the projects that are kind of the dogs. So I think there are on the economic side going to be some risk to Chinese government on this.

**DALI YANG:** Although I agree with Austan on the overall some of the concerns, but China in the process did establish the Asia Infrastructure Development Bank. And that of course, from the beginning, it was much more China dominated. But over time, however, China has multilateralized it much more and it become actually a much actually more transparent organization.

In fact, that bank hasn't been controversial interestingly in how it has operated so far. So there are aspects of the program that has worked quite well. China has learned in the process, but there are other aspects that are much more political [INAUDIBLE]. For example, the investment in Pakistan, which is by no means an easy country to invest anyway. Then it's much, much more challenging.

**MICHELLE CARUSO-CABRERA:** Do you want to weigh in?

**KENNETH POMERANZ:** Yeah, I just want to pick up on two things. One is the dollar is right I think two point us to the significance of the AIIB, which has tried to mimic many of the practices of the other multilateral investment agencies. That said, the big bucks at least so far don't come from AIIB. They come
from the Chinese Exim Bank and the China Development Bank, which are single nation entities. So it's a complicated mix.

MICHELLE CARUSO-CABRERA: And it's not clear to me that they actually want or need these investments to be economic. I mean, to kind of answer what you were going to, Austan, it's not that-- but go ahead. I mean, do they want them to be profitable? Do they want them to be--

KENNETH POMERANZ: They certainly want some of them to be profitable. There are a mixture of motives, and I think we don't always know exactly what that mix is. But look, a lot of it is simply development lending. Some of it certainly is geostrategic. And some of it, if you wind up with a lemon, make lemonade. So if you have a deep water port that you've built in Sri Lanka and it turns out that that was a really, really bad investment economically speaking-- Sri Lanka didn't need a second deepwater port.

MICHELLE CARUSO-CABRERA: But they got one.

KENNETH POMERANZ: What?

MICHELLE CARUSO-CABRERA: But they got one.

KENNETH POMERANZ: They got one, and it just happens to be in the hometown of the former political leader, which is part of the issue. But then you’re left with this thing. So you want to salvage something from it. You wind up with a 99 year lease on this place, and then people in the West start stroking their chins and saying, gee, you could put ships there including naval ships. And people start to get nervous, but that doesn't prove that that's what they were after all along.

I think what it suggests is that, like any other actor, if the opportunities change, they will try and take advantage of a different set of opportunities.

AUSTAN GOOLSBEE: I mean, to your question-- your question was kind of like, well, maybe it wasn't about economics. Maybe it’s just a foreign policy slash geopolitical move.

MICHELLE CARUSO-CABRERA: Donation.
OK, but then that's the question. Is it a donation? If the Chinese government is saying, we're going to donate $1 trillion to poor countries around China, I have a feeling that that will internally be relatively controversial.

We tend to think China as being this unitary act of rational planning for the long run and all that. When you really look back, China got a lot of money burning in the pocket. With $4 trillion in foreign exchanges, they suddenly gained a lot of confidence through the Asian financial crisis actually, [? premier, ?] the Chinese leaders were basically telling, for example, including secretary Paulson, basically saying that we used to learn from you.

And now we don't know who to learn from anymore. And instead, they felt that they can get away with anything practically. And suddenly, they just rushed out. I think it's a vast bandwagon because many companies jumped onto the bandwagon, thinking that they can make money off the government, too, actually.

Two things to add to that I think along a very similar line-- one is that one of the reasons that Belt and Road is so amorphous is that it consists of a lot of separate initiatives suddenly coming together or not so suddenly.

Because it already existed--

Right, when the guy in charge and who is going to be in charge for several years to come says, my signature initiative is Belt and Road, all sorts of people suddenly discover that the things that they were already planning to do would fit under Belt and Road. So not everything that's now in those nice maps that you can flash up on the screen that seem to look like they're a plan, not everything was planned.

But let me just leave the second point for a minute. No, go ahead.
MICHELLE CARUSO-CABRERA: So the criticisms of debt trap diplomacy, economic imperialism-- are they justified?

DALI YANG: Well, I think in certain areas, in the case of Sri Lanka, this issue of economic colonialism actually becomes extremely complicated because it's the historical analogy-- when Ken mentioned. For example, China getting use of that port for 99 years, suddenly people remembered is how long the British took possession of the new territories in Hong Kong-- 99 years.

Somehow of course if the British were not doing it properly in terms of politics, suddenly it doesn't look good for China, which has been advocating respectful sovereignty of other countries, not interfering in internal affairs of other countries to do so and be seen as being extremely benevolent. It becomes actually very difficult. It is very easy for local politicians, let's say, whether it's in Sri Lanka or in other countries, to criticize such arrangements.

MICHELLE CARUSO-CABRERA: What do you think, Austan?

AUSTAN GOOLSBEE: I think that the Belt and Road initiative would be such at an early stage, and they already got repayment problems in Pakistan and they're already feeling like, well, wait we built a huge port, but did we need to build that port. That doesn't bode that well for the-- I don't know if you'd call it the governance or the strategic component.

And I think that, as the economy slows a bit, if they were to have any kind of credit crunch or financial crisis, there are going to be a lot of domestic demands on-- if there's $3 trillion, $2 trillion, however many trillion of foreign reserves are there, what should the money be used for? I just find it very hard to imagine that they're actually going to take the money and go spend it in Tajikistan when there's a quiet credit crunch going on in China. So I kind of think maybe we've overblown the importance of the Belt and Road Initiative.

MICHELLE CARUSO-CABRERA: To hone in on the question earlier, when people use the phrase economic imperialism or debt trap diplomacy, it suggests they think, ah, the Sri Lankan port, that was the plan. We're going to give them all this money. We're going to lend them this money. They're not really able to pay it back. And then we can take the collateral, and that's now our port. Does anybody think that that was the intention or this is just, they mailed them the keys and they were like, wow,
we made a big mistake here economically.

**DALI YANG:** Well, I think the challenge for us in assessing such programs is really the heuristics. Chinese companies, Chinese officials when they do projects, very often they begin with what they know. And they tend to want a lot of especially state companies and so on want control. So there were a lot of good intentions when the Chinese leader emphasized how to help certain countries, especially for example in Central Asia and so on and in reaching out to Southeast Asia.

So there was a lot of goodwill, but the challenge, however, is when someone comes and said, I have $1 billion here. I want to use it. But of course, they are also going to use it in a way that they like to have control. So always the rhetoric and the reality do not always come together. And of course now, as well the problems become known, of course people are going to take a second look.

In fact, including Chinese entities, they are actually re-evaluating. And in fact, every major city—well, not every major city. Many major cities in China have trains running all the way to Europe. Is that economical for example? It’s not, actually. [INAUDIBLE] But at the same time, they did it because someone else had it.

**MICHELLE CARUSO-CABRERA:** Is the mic OK?

**AUSTAN GOOLSBEE:** Something just changed, yeah.

**MICHELLE CARUSO-CABRERA:** Yeah, OK. I think the-- did you want to--

**KENNETH POMERANZ:** Yeah, if I could just jump in on that. I mean, I don't think-- at least as far as we can tell, I don’t think there was an intent to, for instance, wind up with a 99 year lease on this thing. That seems to me too cynical an interpretation. At the same time-- and I think this gets back in some ways to some of what Austan was saying-- some of these loans are just bound to go sour. You’re lending in places that include a lot of places where corruption is a serious problem.
MICHELLE CARUSO-CABRERA: That couldn't get loans otherwise.

AUSTAN GOOLSBEE: And they couldn't get loans in the other two channels.

KENNETH POMERANZ: And so you may well have the genuine consent of your partner in that country. But if you're partner in that country is somebody who doesn't enjoy the support of their people, then at some point some of the people are going to look at you and say, yeah, you were in business with our former prime minister. We didn't like our former prime minister. That's more or less what seems to have happened in Malaysia, in Sri Lanka, to some extent in Myanmar. It's just an inevitable part of this.

I mean, FT had a piece a few months ago, and I wasn't quite sure where their data came from. But they were saying 14% of projects in Belt and Road were running into problems. I don't know how good those numbers are. But if those are the numbers, that's a pretty high percentage.

MICHELLE CARUSO-CABRERA: That's very, very high. I mean, if you think back to the US financial crisis in the United States, the percentage of loans that went bad, the percentage of mortgages that went bad for a US bank-- what was it, Austan? I mean, I think it was less than--

AUSTAN GOOLSBEE: It would. But look, if you gave the non-performing loans share of these loans to 14%, that'd be an astounding triumph.

MICHELLE CARUSO-CABRERA: You think it's going to be--

AUSTAN GOOLSBEE: It's going to be way higher than that. It's going to be way-- if you at emerging market countries that haven't been able to get lending for their infrastructure projects on the private market or from the World Bank and we're going to do things over the next 20 years, I would predict that non-performing loans would be 2/3. If you had one that performed, I'd be like, wow, they had a performing loan.

So the thing is I think, if the Chinese government were evaluating this on strict economic
grounds, most of the indicators say it wouldn't be that great of an economic idea. So it has to have been part of some broader foreign policy argument, which is fine. You can, I believe, not curry favor, but establish some bona fides with countries if you say, look, we’re in this for the long haul. We want to invest in your country. We want to invest in our relationship.

If that extends to, we’re going to make you gigantic loans and, when you can't pay them back, we’re going to repossess the port or the dam or whatever. I mean, now you've just inherited yourself a military foreign policy problem because the only way you enforce that is the Chinese military shows up and says no, this is ours. You have to pay us back.

And I will just observe. There are a whole bunch of strong man dictator types that arose in South America, Latin America exactly in populous response to the United States acting in that type of way. If you look all over the foreign policy history of how countries react when they owe money and there’s some question about the legitimacy of the loans and, wait a minute, this was all in with the previous prime minister, but we overthrew that government. So we don't owe the money anymore. I think there's just a lot of layers of this that they may not end up enjoying.

MICHELLE CARUSO-CABRERA: The non-performing loan number is interesting. Where did they get that number? It's very--

AUSTAN GOOLSBEE: That's like 14% are non-performing already. But I mean, it's just started.

MICHELLE CARUSO-CABRERA: But the broader point I'm trying to make is that there's very little transparency about the actual program. There’s one international mining company that I came across where they brag on their website that they have accumulated a proprietary data set on Belt and Road, trying to keep track of where everything is because there's no place-- in the United States we'd have a website. The US government would have a website. They'd say, this is how many jobs went to California, this is how many jobs went to-- we don't know almost anything about it when it comes to real hard numbers.

DALI YANG: This is very interesting. You see now China actually has the equivalent of a USAID now in China. It didn't exist five years ago. It didn't exist three years ago, didn't exist two years ago. Now it does because China is adapting, trying to build up bureaucracy to handle many of those things. So they are learning.
But at the same time, the costs are quite high, and China has written off a lot of loans to Africa and other countries in fact. So in many ways, the leadership is fully recognizing some of the challenges [INAUDIBLE].

**MICHELLE CARUSO-CABRERA:** I want to make sure I understand what the conclusion you’re drawing. The reason they’ve started a similar USAID program is that they’ve seen that the lending or the things that they’ve done in Africa, the investment sector, et cetera, have not gone as well as they plan and therefore they need to improve the underlying infrastructure, the governance in those countries-- am I reading too much into what--

**DALI YANG:** No, in the sense that within China-- in the US, we have a USAID associated and part of the US Department State essentially. So there is close coordination between the Department of State and USAID, which also works with DoD and other entities. In the Chinese case, actually we had a tiny number of people in the Ministry of Commerce handling a lot of foreign aid and other issues historically. There’s just not enough of an infrastructure within China.

China is known for its bureaucracy. Did not have a significant bureaucracy in handling foreign aid and other associated issues. Now it’s finally established one, which actually will be playing a greater role. And they need one because, given the challenges facing a lot of the spending, the lack of coordination, and so on.

**AUSTAN GOOLSBEE:** Look, if they applied AIIB type criteria to evaluate those projects, I think that would shrink the overall size of the Belt and Road Initiative, but it would make it a lot more sustainable. And you could see, ah, here’s what they’re trying to do. Here’s how they’re evaluating, and here’s what the goals are.

**MICHELLE CARUSO-CABRERA:** I think a lot of the suspicion in the West about the BRI comes because, in addition to BRI, there’s Made in China 2025. And they see both of these initiatives and think, this is about the Chinese trying to do a lot more than just infrastructure investment in the region. It’s about Chinese supremacy and in so many different ways. Am I right about that? If it was BRI alone, it’d be one thing. But when you have Made in China 2025, which I outlined some of the things that Mike Pence said about that during his speech, that really is what-- it’s the whole body of these programs that concern people in the West.

**AUSTAN GOOLSBEE:** I think a lot of people feel that. When you said, are you right, are you right about that’s what the people in the West think or are you right that that is what--
MICHELLE CARUSO-CABRERA: I think, yes. When you add the two of them together, that's what grows--

AUSTAN GOOLSBEE: I think that the fact that both of those things are happening, there is a group in the United States that you can see that's got a certain paranoia of the conspiratorial genius somewhere is sitting in a room in China. And they have a design to take over the world, and anything that's announced in that style is going to be read through that lens. I think that's fair.

Now the only thing I'll say about the China 2025 program is, as an economist, I kind of view it as a similar mistake or there's at least a similar susceptibility of that program as with the Belt and Road Initiative, which is it's all about trying to establish primacy in a manufacturing setting, in a high tech-- we want to be the high tech leader of the world.

MICHELLE CARUSO-CABRERA: Robots, AI.

AUSTAN GOOLSBEE: Robotics, AI, and it's kind of listing. Somebody in the government's listing, these are the industries of the future that we're going to want to lead. And if you look at the economy of China and compare it to all the richest countries of the world, there's a huge, glaring difference. And that huge glaring difference is what people spend their money on in rich countries are predominantly services and their health care and education, financial services, leisure and entertainment, a whole bunch of stuff, that make up the majority of what we spend our money on. And that has not been true in China.

So if you said, 10 years from now, 20 years from now, when China is much richer even than it is today, overwhelmingly the most likely thing is that they're going to be spending a lot more of their income in areas that are not in the 2025 program. And so there is at least a risk that you again pour tons of government resources into certain centrally chosen industries, whereas with Belt Road Initiative it's countries, that they end up looking back and say, oh, god, we spent $50 billion on robotics and then that didn't end up being a very big industry in China.

MICHELLE CARUSO-CABRERA: You're verbalizing the classic picking winners and losers, which--
AUSTAN GOOLSBEE: Yes.

MICHELLE CARUSO-CABRERA: --Milton Friedman just absolutely [?] hates. ?]

AUSTAN GOOLSBEE: Whenever Michelle would have me on CNBC, the conversation would always be, but what would Milton Friedman say about that.

MICHELLE CARUSO-CABRERA: Dali, you wanted to raise your hand, and I see, Ken, you’re also--

DALI YANG: Yeah, I think the issue historically-- of course China has had a significant industrial policy. It has evolved over time. Of course industrial policies do work when especially at lower levels of development because you just emulate. You can learn what have happened in other countries and target resources into certain areas. China has done extraordinarily well in that regard.

But at the same time, in the newer areas, including [INAUDIBLE] e-commerce and so on, China has also come a long way very often initially by emulating. For Amazon, China has for example Jingdong. For eBay, China has Alibaba and so on. But then they went beyond that. They began to make massive investments actually, and they are becoming competitors to American companies in that regard.

And China also wants to, in fact, especially with the current tussle in semiconductors and so on-- the Chinese government want to make sure that they continue to be strong, they have access to the technology, and they want their own technologies. In that sense, I think this all comes together on this goal of modernization, fully modernizing China by 2050. So in that regard, actually it’s part of that mission.

MICHELLE CARUSO-CABRERA: But that’s a very statist attitude that a lot of economists would think is actually self-defeating eventually. I mean, the reason Alibaba has been able to grow, the reason WeChat’s big is because they don’t allow Twitter, they don’t allow Facebook, they don’t-- they make it very, very difficult for US companies to go in.

DALI YANG: You’re absolutely right, but I’m a political scientist in this regard. And I’m saying, in fact, there
are many Chinese interests who do feel like some of the censorship has actually paradoxically allowed Chinese companies to become much more prominent. Without Twitter, Weibo and so on has done down better. And those are multibillion dollar companies globally. And as a result, actually they have done quite well.

China uniquely in fact has practically almost the same-- well not exactly the same number-- has the second largest certainly number of unicorns-- private companies that are valued at more than $1 billion or so-- compared to other countries. So in that sense, actually China has done extraordinarily well.

The government incidentally has also encouraged funding-- local governments have also poured funding into private equity as well. Many of them are run by U Chicago alums in fact.

MICHELLE CARUSO-CABRERA: Interesting, we'll see how all those investments work out. But what you're describing is basically a technological version of import substitution, so to speak. Ken.

KENNETH POMERANZ: Yeah, I think there are a couple things here that we want to-- they're all operating, but we want to keep them at least partially separate. I mean, one is Austan's concerns, which are in a way classic economists concerns.

AUSTAN GOOLSBEE: Yep.

KENNETH POMERANZ: This may not be the right way to allocate investment, but that's not what's bothering Washington. Washington frankly doesn't care if the Chinese make some bad investments. Washington is worried about, what's the global impact of this, what's the-- they're not worried that it will fail. They're worried that it will succeed.

MICHELLE CARUSO-CABRERA: It's true.

KENNETH POMERANZ: And there, I think, one of the things that's very difficult to confront is that there's just an irreducible difference in the way the systems work. Any government in the world has the perfect right to say to that, we would like to set the goal of having x market share in x industry by a certain date.
The difference is that in a country like the United States, if the government announced that, well, that's a pious hope and business has many, many ways of simply ignoring that. You can't get around the fact that in China people feel a good deal more pressure to help meet those goals, even in the private sector, not to mention in the SOEs.

MICHELLE CARUSO-CABRERA: State Owned Enterprise.

KENNETH POMERANZ: Right, so there is a real difference in systems that I think, on the one hand, can make the Chinese say, well, we're just doing what any country can do. We're trying to think about our future.

MICHELLE CARUSO-CABRERA: Make China great again.

KENNETH POMERANZ: Right, but that sounds from the point of view of somebody who's looking at-- what are the WTO rules, what are you actually allowed to do-- that starts to look very different. The other thing I would just say, and here we should remember, it's simply a fact that China is sitting on an awful lot of capital right now. And to some extent--

MICHELLE CARUSO-CABRERA: The trillions of dollars of US treasury bonds.

KENNETH POMERANZ: To some extent, people are going to be nervous no matter what they do. Five years ago, when they were plowing most of it into T-bills, we got ads in our 2012 election that showed this paranoid version of China owning America.

MICHELLE CARUSO-CABRERA: We owe China all this money. I mean, we do--

KENNETH POMERANZ: And so now, they don't want to put it all in T-bills. They want to do some other things with it.

MICHELLE CARUSO-CABRERA: And then we get nervous if they're going to sell it all.
And we get nervous about those things, too.

Right, right, and drive up interest rates. But the way you talked about the very different systems-- in the United States, government can say, it wants to do this, but business can have another idea. Not the same situation in China. It goes back to one of the last things that Hank Paulson said when he was sitting here, which was the ascension into the WTO.

In the West, they assumed that China would move towards more open markets over time, more and more and more. I can't tell you-- after the WTO, China going into WTO, there was a banker in New York who called me-- I kid you not-- every week and he told me, it's going to be announced this week. We are going to finally be able to have our own banking license in China. I mean, it went on for months, then years, and then he stopped calling me. It never happened. It never happened.

We're still talking about the financial services sector not being open and still being subject to joint ventures. Did the Chinese always move so slowly? Are they moving backwards? I mean, Belt and Road and Made in China 2025, Austan, as you point out, is about picking winners and losers. And when Hank Paulson talked about Deng Xiaoping, and when Mr. Pritzker talked about Deng Xiaoping, it was about the inevitable move towards more markets and a more open economy.

Yeah, they moved a little backwards I think or, if not backwards-- to get from poor to middle to higher middle income often involves a very different thing as than getting from that to being a rich country. And you've seen the middle income trap, which they referred to on the previous panel.

I guess I interpret usually the middle income trap as something different. It's not, ah, China needs to upgrade its value added and get more--

Does everybody understand what the middle income trap? Historically, we've seen underdeveloped countries, developed countries, they finally managed to get their GDP per capita up to x level-- let's say, $10,000 maybe. And then they get stuck, and they just [INAUDIBLE] down. And they can't--
AUSTAN Goolsbee: So they're growing 7%, 9% per year, and then--

MICHELLE Caruso-Cabrera: Right, hockey stick.

AUSTAN Goolsbee: And I think that's because, once you get to a not less centrally directed, let us copy this industry, let us copy that industry, but we can do it for cheaper than anywhere else-- now it starts to become-- and you have seen it. Look, China is not that cheap of a country anymore, because they have higher productivity and therefore they have higher wages and they have more technology.

So the people who are just looking for what's the cheapest place in the world, they move to the next place.

MICHELLE Caruso-Cabrera: Bangladesh.

AUSTAN Goolsbee: So then you got to decide on a series of regulatory moves, on a series of things with state owned enterprises, on a series of decisions about foreign direct investment, about property rights, about intellectual property. Do you want to do a thing that continues to enable the control or do you want to do the thing that would enable new entry in startups to challenge the existing incumbents, who are very powerful?

And that's the devil's bargain or something that countries tend to face when they hit the middle income trap-- is the central government often said, well, wait a minute, we do not want to give up control. And whether it's in financial services, forget about the foreign aspect. Just domestically, the big banks we control them. We can tell them what to do, who to lend to, what-- and we can oversee them.

And all these alternative financial products, we [?] and that means they're both dangerous but they're also enabling of these new firms. And so I think those are going to be the kinds of things that the Chinese government increasingly they have already and they're going to increasingly face choices like that. And that's uncomfortably only partially overlapping with conflict with the US.
Most of the challenge that the Chinese government is going to face on the economy kind of has nothing to do with the United States, and it's going to be about stuff like, are we going to continue with the same business model that we have had. And in the US, we tend to view China as an export led growth model. That kind of ended five, eight years ago. And China shifted to an investment led growth model.

And the thing about investment led growth models is they go until they stop. And because investment goods are durable goods, if you overshoot, it can mean in the short run big problems. And so I think the managing the transition from investment led growth to something else is going to be the bigger thing.

MICHELLE CARUSO-CABRERA: Dali, you wanted to say something.

DALI YANG: Yeah, I think historically it's very important for us to keep in mind-- when China joined the WTO in 2001, China joined as a developing country. It was a much smaller economy. So China felt that it has to do this and that in order to satisfy the requirements of the existing WTO members. But at the same time it was given, a lot of exemptions of special treatment as a developing country. There are still a lot of countries that are developing countries.

But then China has much greater capacity than most other developing countries to turn around, including hiring American lawyers to help it fight in the WTO. But at the same time, China has become the second largest economy-- an economy of $12 trillion dollars maybe around this time. So it still wants to be treated as a developing economy.

MICHELLE CARUSO-CABRERA: But it's not.

DALI YANG: Exactly. So that's really the unease we have about China. And China itself actually is finally beginning to learn to realize maybe, in fact, many Chinese are not happy about the tariffs on certain goods. For example, the Chinese government recently eliminated tariffs on cancer drugs being imported into China. Cancer drugs were subject to very high tariffs going into China. Those are treatments badly needed by the Chinese.
And while they weren't actually really not the 7% or 8% that averages for goods but much higher, and then there are taxes and other things as well. So now they are finally beginning to lower this and for the good of the Chinese people as well.

MICHELLE CARUSO-CABRERA: We have questions, cards, somebody? Why don't send some of these up? Let me take a look here. What are the risks to China from large scale failures of BRI investments?

AUSTAN GOOLSBEE: What other risk? Money, money is the only risk. Actually, it's not the only risk. As I said, money problems can spiral into geopolitical problems, but I think we should not underestimate the importance of those money problems. In the financial crisis, what you saw were the financial regulators in each country, in the US, in each of the European countries going to their own banks and saying, wherever your money is, you get it back here because we need the capital here. And that made some problems worse, and that could have happened--

MICHELLE CARUSO-CABRERA: There is a follow up question on the card. So I think where this person is going-- are there real blowback financial risks? In other words, if there are large scale failures in the BRI, does it have a wider implication for the Chinese economy, which-- I read the headlines in the South China Morning Post every day-- I wonder if there are stability issues or, at minimum with the stock market down more than 25%, just a slowdown coming in the Chinese economy. And could large scale failures have one of those--

The Kyle Basses of the world-- he's a hedge fund manager who talks about what he says is the inevitable implosion of the banking system because of all the non-performing loans.

KENNETH POMERANZ: I mean, I think there are a couple of things. I mean, one is exactly what Austin said, that bad loans are bad loans. And if you need the capital at home, you've got a problem. The second thing is simply-- and this is not a catastrophe, but it's a problem. As Dali pointed out, one of the reasons for Belt and Road was simply you have this enormous overcapacity in areas like steel, cement, et cetera. There's only so much more cement you can pour in China.

BRI is clearly, among other things, a response to that overcapacity. If a bunch of these projects go belly up and, therefore, you don't have more of them coming online afterwards, there are going to be a lot of companies, a lot of municipalities in Western China that are banking on becoming trade hubs for trade to inner Asia and to South Asia. There will definitely be repercussions for the domestic economy. I don't think it's going to be a crash, but it's going to be unpleasant.
DALI YANG: To the extent that the BRI is considered to be part of this plan of China to dominate the globe, actually having some failures helps China to be seen as fallible, as not being bent on domination, where even if it wants to, it's not capable of doing so.

But at the same time, economically they are making some adjustments already. And fundamentally, a lot of the economic issues in China are domestic rather than related to the BRI.

MICHELLE CARUSO-CABRERA: How is the BRI viewed within China? Is political support widespread? And what about within the government?

DALI YANG: Well, I think politically there was, as I mentioned earlier, a lot of jumping onto the bandwagon--local governments, state companies in particular, private companies, too. They all jumped onto the bandwagon, all hoping-- and in fact some foreign governments did as well, although very often gradually the Chinese government wised up and decided, oh, I'm not going to give you a loan on this and that [INAUDIBLE] because there is a cost to the capital and so on.

But over time, however, especially over the past year, I detect there is growing unease about this growing Chinese generosity globally, both actually through the BRI and in other ways. So I think actually there are more questions being asked of how we are spending the money and especially China as China tries to save and to conserve its foreign exchange reserves at this very moment.

SPEAKER 2: To the person who asked, are there comparisons to the Marshall Plan, we asked that at the very beginning. So play back the tape. As capital becomes more accessible via funds for Belt and Road, how will the role of the World Bank shift? And I will add, if at all.

AUSTAN GOOLSBEE: I think the AIIB is more of the direct competitor or equivalent to the World Bank in the same dynamic that I described that there is a bunch of private market capital available now in a way that, when they set up the World Bank-- and in the post World War II era, there kind of wasn't--there has been this soul searching at the World Bank of, well, why do we exist. Now the capital markets of the world are so developed, if you have an NPV-positive project to build a hydropower dam or something, can't you get funding for that? So are we getting a selected sample of the worst of projects that can't cut it in the private sector?
In a way, the AIIB I think—look, maybe it’s better that we get some competition for these big multinational institutions. At the same time, I would hate to see a thing that turns into, the US wants its own sphere of influence, China wants a sphere of influence, Europe wants its own version, and we’re all just going to overlap.

MICHELLE CARUSO-CABRERA: Don’t you feel like we’re there now?

AUSTAN GOOLSBEE: Ah, I don’t think we’re there yet. All of those things have set up, but the arms race feature that I’m afraid of, I don’t think the arms race has grown up.

MICHELLE CARUSO-CABRERA: And [INAUDIBLE].

KENNETH POMERANZ: Yeah, I mean, I think the positive news recently is that there have been some projects where the AIIB is going in together with the existing, multilateral development banks. And that’s I think good for a whole bunch of reasons, including that it helps make some people feel better about the idea that the Chinese loans are the cut rate competition, the folks who won’t insist on conditionality either in terms of environmental quality or human rights or anything else to the extent that they work with other multilateral development banks that stuff’s resolved.

To the extent that they go their own way, then it becomes a question of either, will they upgrade their own standards so that they’re closer to those of other multilateral development banks, in which case though they’re not going to be lending in some of the places they’re currently planning to lend. Or do they continue lending in the places where other people don’t want to lend, in which case it doesn’t really have any impact on the World Bank? They weren’t going to go into [INAUDIBLE].

MICHELLE CARUSO-CABRERA: Did you want to say something, Dali?

DALI YANG: Yeah, I think historically China is the most successful graduate of the World Bank lending in fact. So it’s actually proper and really great to see other countries, including China now, having grown to become a lender in that regard in fact, so through the AIIB and so on. What’s
interesting now is the AIIB already works with the World Bank on certain projects. And the US and China also are in various areas, even with some of the conflicts we actually have coordinated, is this donor coordination is very significant.

And I think together, in many areas, we can do better in fighting against disease and poverty in many parts of the world. And I think China should have a role. And in fact, it’s great that China is doing so and especially in a more transparent way. I think actually that's going to be very welcome. And already actually that coordination is beginning to happen.

MICHELLE CARUSO-CABRERA: You do point out something important. China, you say, is a successful graduates of World Bank programs. I mean, the current administration thinks they actually haven't graduated yet. I mean, China still gets-- they're the biggest borrower from the World Bank, even though, like you talked about with the WTO, they're not a developing nation anymore. It's another place where there is a lot of tension between the US and China.

After the World Bank MIF meetings, Treasury Secretary Mnuchin made very clear he was very upset about the degree to which China was borrowing from the World Bank at very cut-rate loans.

DALI YANG: Well, then there we have to ask about the bank because, for the bank, lending to China is great. You get the money back. So therefore, the bank has been very eager to lend to China historically.

MICHELLE CARUSO-CABRERA: China COSTCO-- does everybody know what this company is this? I associate them with ports and stuff because they in the port in Piraeus, Greece, for example. China COSTCO and CMA CGM of France control many ports in Western Europe and Latin America and the United States. Won't this allow them to do what Tom Pritzker warned about with hotels-- turn off lights, turn off the power?

What I hear in this question is the, should we let foreigners own those assets in our hemisphere because, are we at risk of them turning off the lights.

DALI YANG: Well, why don't I jump in? [? 1901, ?] Panama Canal-- Hutchison Whampoa, which is a Hong Kong company, owns the Panama Canal. We're not worried about that actually [INAUDIBLE]. So overall, I think if you place the management of those ports under the proper regulatory framework, they're not going to be taken away right.

It's not like actually, if they have a stake in the Port of Los Angeles or Portland and so on, they
can just take it away to China. The port would be useless if there is no traffic, and that traffic depends on the European market, depends on the American market.

AUSTAN GOOLSBEE: Look, we have rule of law still I think. In the United States, that argument is fundamentally saying, does the ownership of something in the United States give them the right-- it certainly doesn't give them the right. Does it give them the ability to disregard the rule of law in the place where the port is located? It doesn't in the United States. You're not allowed to do-- you're not allowed to go shut down the Port of Los Angeles.

MICHELLE CARUSO-CABRERA: Your contract says you've got to run the port. You run the port.

AUSTAN GOOLSBEE: And if you did, all the force of enforcing the rule of law in the United States would apply. So I think that goes to-- there's a group of people who have a conspiracy view about China in general. If China has anything to do with it, then it's probably a strategic plan to nefariously undermine the United States.

MICHELLE CARUSO-CABRERA: Yeah, I think back to when-- do you remember--

AUSTAN GOOLSBEE: If you had evidence that, by buying this thing, a French company and a company at a Hong Kong owned port, it would give them the ability to have a back door or whatever and they could spy on everything that was in it, then I think that would be a perfectly legitimate reason on national security grounds to apply more scrutiny to it.

They got in this with the port in New York where it was like, ah, Dubai Company's gonna--

MICHELLE CARUSO-CABRERA: Dubai Ports [INAUDIBLE].

AUSTAN GOOLSBEE: --own somebody who runs a subsidiary that didn't in any way change the physical control of who did the inspection.

MICHELLE CARUSO-CABRERA: No, and that came in the wake of September 11th, and there was a lot of distrust of the Middle Eastern and ownership. What was ironic about the ports story is that they ended up busting.
CABRERA: So that deal didn’t happen. It got canceled. And then they busted all these port workers who were supposed to be involved in security. And one guy went down for watching porn on his computer all day. Like we were all worried about security because the Middle Easterners were going to control the port when in fact our own employees were not doing the right job.

I think back also to—remember when the Chinese company want to buy Unocal, the oil company, and that got canceled too. I mean, there was a hue and cry—oh my gosh, are the Chinese going to own oil assets here. And it was pointed out by a lot of economists, when the assets in your country, you can do what you want. I mean, ultimate—

AUSTAN GOOLSBEE: I mean, it's back to the port in Sri Lanka. If you don't [own] it—

MICHELLE CARUSO-CABRERA: I mean, the US can certainly.

AUSTAN GOOLSBEE: Like what are the—who—possession is 9/10ths of the law.

MICHELLE CARUSO-CABRERA: Yes.

DALI YANG: I think in the case of the oil assets, there was genuine concern about access to the shale technology, although of course the Halliburton's of the world actually operate in China nowadays as well. The challenge is the Chinese terrain is not as good to—even though they have a lot of shale reserves—

MICHELLE CARUSO-CABRERA: They don't have enough water, right?

DALI YANG: Yeah, that right, yeah.

MICHELLE CARUSO-CABRERA: You need so much water for shale.
KENNETH POMERANZ: But I mean, that's the distinction that matters I think. Ownership of technology in some cases does raise potential security problems because technology is movable. An ownership right in a physical asset like a port in another country doesn't really give you the ability to do much of anything.

MICHELLE CARUSO-CABRERA: Austan, what do you think of the new CFIUS law? This is going to be the last question, and you guys can all weigh in on this. The Committee for Foreign Investments in the United States used to be defined very, very narrowly about any time a foreign company wanted to buy US asset, particularly technological, there was a very narrow window where they looked at, should we be concerned about technology transfer.

Congress-- I mean, both sides of the aisle-- got on board with a much widening definition of what was going to be at risk, how to look at it. I know I've heard people argue, we should worry about economic risks, not just technological risks. If you were--

AUSTAN GOOLSBEE: Look, we don't know what it's actually going to be. To the extent that it's just going to be used as a bludgeon and it's not setting up a process to actually evaluate national security, but it's instead just trying to give more power to the executive branch to use more threats, I think we might want to think twice about that.

I would point to the example of the tariffs now that the Constitution specifically says it's Congress who's supposed to be deciding tariff policy. It's not supposed to be that the president can get up and say, well, today I'm going to add it to $500 billion of new goods. And so that led me to, I'm not a lawyer, I've certainly going to-- on what authority-- how is the president able to do that?

And they said, well, in the Trade Act of 1961, there was some reference to, if there is a threat to national security, then the president could impose duties. And they're using that to drive all of the $500 billion dollars off PEZ candy and toys are the threat to national security from whirlybird toys.

MICHELLE CARUSO-CABRERA: Mostly focused, though, on steel. I mean, Wilbur Ross makes it clear he wants more smelters here. He's worried, if we ever go to war, we can't produce our own steel.

KENNETH POMERANZ: And it was to be against Canada, but my point is opening the door to national security things, if
POMERANZ: there are national security interests, then I’m 100% on board with, let us apply some-- but let us have a framework of how we think about that. If what this is going to end up being used as is, let’s find ways to attack the Canadians for their milk production, then I think it’s goofy.

MICHELLE CARUSO-CABRERA: Final comments? Anything I should have asked, you expected me to ask?

DALI YANG: Well, the CFIUS, this is a bipartisan moment on those kind of issues. The current CFIUS process is fairly ad hoc and non-transparent. So there are a lot of issues with the current process, the inviting foreign acquisitions and so on. So to the extent that this new law would help to standardize and perhaps makes the process a little more something of that nature, it should be welcome.

But at the same time, there is also this fear of, let's say, in particular China, then of course is the legislation of the moment, and it will reflect the fact that historically we have had various legislations driven by fear of the foreign. So to that extent, very often it tends to overreact a little bit.

KENNETH POMERANZ: Yeah, I think generalize that for a minute and think back to the panel more generally, we tend to talk in terms of a taken for granted liberal order. And is China moving close enough to it? Are they backtracking, et cetera? You have to remember, that liberal order is a moving target and at the moment a rather unstable target itself.

MICHELLE CARUSO-CABRERA: And not that old.

KENNETH POMERANZ: What?

MICHELLE CARUSO-CABRERA: And not that old.

KENNETH POMERANZ: And not that old. And so there’s both reasons why some people in China-- hard to tell how many-- A, genuinely think, hey, maybe we have a different idea that's just as good and, B, why some people are saying, well, it would be fine to insist that China conform to the international
rules based order. But then we better be clearer about what it is and clearer about our own intent to conform to it because right now we’re not doing terribly well.

MICHELLE CARUSO-CABRERA: Well, this has been a great discussion. I really enjoyed it. I hope you guys did too. Thanks to our panelists for joining us today. We're going to take a quick break. We're going to see you back for next discussions-- diplomacy in an era of trade tensions-- with two prominent former ambassadors. It's going to be great. We'll be back in about 15 minutes.