

stars insights: 8 October 2020

«There are Three Things China Still Fears About America – The Dollar is One of Them»



Picture: Laurent Burst via Zoom

*In an interview with **Mark DITTLI** for *The Market* – a media partner of stars – the Honorable **Kevin RUDD**, former Prime Minister of Australia and President of the Asia Society Policy Institute, warns of a progressive decoupling of China from the United States in fields such as trade, direct investment, technology and financial markets.*

Few Western observers know China better than The Honorable Kevin Rudd. As a young diplomat, the Australian, who speaks fluent Mandarin, was stationed in Beijing in the 1980s. As Australia's Prime Minister and then Foreign Minister from 2007 to 2012, he led his country through the delicate tension between its most important alliance partner (the USA) and its largest trading partner (China).

Today Mr. Rudd is President of the Asia Society Policy Institute in New York. In an in-depth conversation via Zoom, he explains why a fundamental competition has begun between the two great powers. He would not rule out a hot war: «We know from history that it is easy to start a conflict, but it is bloody hard to end it», he warns.

Mark DITTLI: Mr. Rudd, the conflict between the U.S. and China has escalated significantly over the past three years. To what extent has that escalation been driven by the presence of two strongmen, i.e. Donald Trump and Xi Jinping?

Kevin RUDD: The strategic competition between the two countries is the product of both structural and leadership factors. The structural factors are pretty plain, and that is the continuing change in the balance of power in military, economic, and technological terms. This has an impact on China's perception of its ability to be more assertive in the region and the world against America. The second dynamic is Xi Jinping's leadership style, which is more assertive and aggressive than any of his post-Mao predecessors, Deng

Xiaoping, Jiang Zemin and Hu Jintao. The third factor is Donald Trump, who obsesses about particular parts of the economy, namely trade and to a lesser degree technology.

Would America's position be different if someone else than Trump was President?

No. The structural factors about the changing balance of power, as well as Xi Jinping's leadership style, have caused China to rub up against American interests and values very sharply. Indeed, China is rubbing up against the interests and values of most other Western countries and some Asian democracies as well. Had Hillary Clinton won in 2016, her response would have been very robust. Trump has for the most part been superficially robust, principally on trade and technology. He was only triggered into more comprehensive robustness by the Covid-19 crisis threatening his re-election. If the next President of the U.S. is a Democrat, my judgement would be that the new Administration will be equally but more systematically hard-line in their reaction to China.

Has a new Cold War started?

I don't like to embrace the language of a Cold War 2.0, because we should not forget that the Cold War of the 20th century had three big defining characteristics: One, the Soviets and the Americans threatened each other with nuclear Armageddon for forty years; two, they fought more than twenty proxy wars around the world; and three, they had zero economic engagement with each other. The current conflict between the U.S. and China on the other hand is characterised by two things: One, an economic decoupling in areas such as trade, supply chains, foreign direct investment, capital markets, technology, and talent. At the same time, it is also an increasingly sharp ideological war on values. The Chinese authoritarian capitalist model has asserted itself beyond China and challenges America.

How do you see that economic decoupling playing out?

The three formal instruments of power in the U.S. to enforce decoupling are entity listing, the new export control regime, and thirdly, the new powers given to the Committee on Foreign Investment in the United States, CFIUS. Those are powerful instruments which potentially affect third countries as well, through sanctions imposed under the entity list. You can take the example of semiconductors, where the recent changes of the entity list virtually limits the exports of semiconductors to a defined list of Chinese enterprises from anywhere in the world, as long as they are based on American intellectual property.

These measures have cut off Chinese companies like Huawei or SMIC from acquiring high-end semiconductor technology anywhere in the world. The reaction in Beijing has been muted so far, with no direct retaliation. Why?

In China there is a division of opinion on the question of how to respond. The hawks have an «eye for an eye» posture, that's driven both by a perception of strategy, but also with an eye on domestic sentiment. The America doves within the leadership – and they do exist – argue a different proposition. They think China is not yet ready for a complete decoupling. If it's going to happen, they at least try to slow it down. Plus, they want to keep their powder dry until they see the outcome of the election and what the next Administration will do. That's the reason why we have seen only muted responses so far.

Isn't it the case that both sides would lose if they drive decoupling too far? And given that, could it be that there won't be any further decoupling?

We are past that point. Whoever wins the election, America will resolve in decoupling in a number of defined areas. First and foremost in those global supply chains where the products are of too crucial importance to the U.S. to depend on Chinese supply. Think

medical supplies or pharmaceuticals. The second area is in defined critical technologies. The Splinternet is not just a term, it's becoming a reality. Thirdly, you will see a partial decoupling on the global supply of semiconductors to China. Not just those relevant to 5G and Artificial Intelligence, but semiconductors in general. The centrality of microchips to computing power for all purposes, and the spectrum of application in the civilian and military economy is huge. Fourth, I think foreign direct investment in both directions will shrink to zero. The fifth area of decoupling is happening in talent markets. The hostility towards Chinese students in the U.S. is reaching ridiculous proportions.

Do you see a world divided into two technology spheres, one with American standards and one with Chinese standards?

This is the logical consequence. Assume you have Huawei 5G systems rolled out across the 75 countries that take part in the Belt and Road Initiative, then what follows from that is a series of industry standards that become accepted and compatible within those countries, as opposed to those that rely on American systems. But then another set of questions arises: Let's say China is effectively banned from purchasing semiconductors based on American technology and is dependent on domestic supply. Chinese semiconductors are slower than their American counterparts, and likely to remain for the decade ahead. Do the BRI countries accept a slower microprocessor product standard for being part of the Chinese technological ecosystem? I don't know the answer to that, but I think your prognosis of two technology spheres is correct.

China throws huge amounts of money into the project of building up its semiconductor capabilities. Are they still so far behind?

Despite their acts to buy, borrow or steal intellectual property, they constantly remain three to seven years behind the U.S., Taiwan and South Korea, i.e. behind the likes of Intel, TSMC and Samsung. It's obviously hard to reverse engineer semiconductors, as opposed to a Tupolev, as the Soviets had to find out, which can be reverse engineered over a weekend.

Wouldn't America hurt itself too much if it cut off China from its semiconductor industry altogether?

There is an argument that 50% of the profits of the US semiconductor industry come from their clients in China. That money funds their R&D in order to keep three to seven years ahead of China. The U.S. Department of Defense knows that, what's why the Pentagon doesn't necessarily side with the anti-China hawks on this issue. So the debate between the US semiconductor industry versus the perceived national security interest has yet to be resolved. It has been resolved in terms of AI chips, and Huawei is the first big casualty of that. But for semiconductors in general the question is not solved yet.

Will countries in Europe or Southeast Asia be forced to decide which technology sphere they want to belong to?

Until the 5G revolution, they have managed to straddle both worlds. But now China has banked on the strategy of being the technology leader in certain categories, and the one they are in at the moment is in 5G technology and systems. If you look at the next five years, and if you look at the success of China in the other technology categories in its Made in China 2025 Strategy, then it becomes clear that we increasingly are going to end up in a binary technology world. Policy makers in various nations will have to answer questions around the relative sophistication of the technology, industry standards, concerns on privacy and data governance, and of course a very big question: What are our points of exposure to the U.S. or China? What will we lose in our China relationship by

joining the American sphere in certain fields, and vice versa? Those variables will impact the decision-making processes everywhere from Bern to Berlin to Bangkok.

But in the end, they will have to choose?

Yes. India for example has done it in the field of 5G. For India, that was a big call, given the size of its market and China's desire to bring India slowly but surely towards its side of the Splinternet.

The third field of conflict after trade and technology lies in financial markets. We know that Washington can weaponise the Dollar if it wants to. So far, this front has been rather quiet. What are your expectations?

Two measures have been taken so far by the Trump Administration. One, the direction to U.S. government pension funds not to invest in Chinese listed companies; and two, the direction to the New York Stock Exchange not to sustain the listing of Chinese firms unless they conform to global accounting standards. I regard these as two simple shots across the bow.

With more to follow?

Like on most other things including technology, the U.S. is divided in terms of where its interests lie. Just like Silicon Valley, Wall Street has a big interest in not having too harsh restrictions on financial markets. Just look at the volume of business. Financial market collaboration between the Chinese and American financial systems in terms of investment flows for Treasuries, bonds and equities is a \$5 trillion per year business. This is not small. I presume the reason we have only seen two rather small warning shots so far is that the Administration is deeply sensitive to Wall Street interests, led by Secretary of the Treasury Steven Mnuchin. Make no mistake: Given the serious Dollars at stake in financial markets, an escalation there will make the trade war look like child's play.

Which way will it resolve?

The risk I see is that if the Chinese crack down further in Hong Kong. If there is an eruption of protests resulting in violence, we should not be surprised by the possibility of Washington deciding to de-link the U.S. financial system from the Hong Kong Dollar and the Hong Kong financial market. That would be a huge step.

How probable is it that Washington would choose to weaponise the Dollar?

We don't know. The Democrats in my judgement do not have a policy on that at present. Perhaps the best way to respond to your question is to say this: There are three things that China still fears about America. The US military, its semiconductor industry, and the Dollar. If you are attentive to the internalities of the Chinese national economic self-sufficiency debate at present, it often is expressed in terms of «Let's not allow to happen to us in financial markets what is happening in technology markets». But if the U.S. goes into hardline mode against China for general strategy purposes, then the only thing that would deter Washington is the amount of self-harm it would inflict on Wall Street, if it is forced to decouple from the Chinese market. If that would happen, it would place Frankfurt, Zurich, Paris or the City of London in a pretty interesting position.

Would you say that there is a form of mutually assured destruction, MAD, in financial markets, which would prevent the U.S. from going into full hardline mode?

If the Americans wanted to send a huge warning shot to the Chinese, they are probably more disposed towards using sectoral measures, like the one I outlined for Hong Kong, and not comprehensive measures. But never forget: American political elites, Republicans

and Democrats, have concluded that Xi Jinping's China is not a status quo power, but that it wishes to replace the U.S. in its position of global leadership. Therefore, the inherent rationality or irrationality of individual measures is no longer necessarily self-evident against the general strategic question. The voices in America to prevent a financial decoupling from China are strong at present, but that does not necessarily mean they will prevail.

China's strategy, meanwhile, is to welcome U.S. banks with open arms. Is it working?

The general strategy of China is that the more economic enmeshment occurs – not just with the U.S., but also with Europe, Japan and the likes –, then the less likely countries are going to take a hard-line policy against Beijing. China is a master in using its economic leverage to secure foreign policy and national security policy ends. They know this tool very well. The more friends you have, be it JPMorgan, Morgan Stanley or the big technology firms of Silicon Valley, the more it complicates the decision making process in the West. China knows that. I'm sure you've heard it a thousand times from Swiss companies as well: How can we grow a global business and ignore the Chinese market? Every company in the world is asking that question.

You wrote an article in Foreign Affairs in August, warning of a potential military conflict triggered by events in the South China Sea or Taiwan. Do you really see the danger of a hot war?

I don't mean to be alarmist, not at all. But I was talking to too many people both in Washington and Beijing that were engaged in scenario planning, to believe that this was any longer just theoretical. My simple thesis is this: These things can happen pretty easily once you have whipped up nationalist narratives on both sides and then have a major incident that goes wrong. A conflict is easy to start, but history tells us they are bloody hard to stop.

Of course the main argument against that is that there is too much at stake on both sides, which will prevent an escalation into a hot war.

You see, within that argument lies the perceived triumph of European rationality over East Asian reality. All that European rationality worked really well in 1914, when nobody thought that war was inevitable. The title of my article Beware the Guns of August referred to the time between the assassination in Sarajevo at the end of June, the failure of diplomacy in July, and then miscommunication, poor signalling and the dynamics of mobilisation in the end led to a situation that neither the Kaiser nor the Czar could stop. Nationalism is as poisonous today as it was in Europe for centuries. It's just that you've all killed each other twice before you found out it was a bad idea. Remember, in East Asia, we have the rolling problems of our own version of Alsace-Lorraine: it's called Taiwan.

Influential voices in Washington say that the time of ambiguity is over. The U.S. should make its support for Taiwan explicit. Do you agree?

I don't. If you change your declaratory policy on Taiwan, then there is a real danger that you by accident create the crossing of a red line in Chinese official perception, and you bring on the very crisis you are seeking to avoid. It's far better if you simply had an operational strategy, which aims to maximally enhance Taiwan's ability to deter a Chinese attack.

Over the past years, the Chinese Communist Party has morphed into the Party of Xi. How do you see the internal dynamics within the CCP playing out over the coming years?

Xi Jinping's position as Paramount Leader makes him objectively the most powerful Chinese leader since Mao. During the days of Deng Xiaoping, there were counterweighting voices to Deng, represented at the most senior levels, and there was a debate of economic and strategic policy between them. The dynamics of collective leadership applied then, they applied under Jiang Zemin, they certainly applied under Hu Jintao. They now no longer apply.

What will that mean for the future?

In the seven years he's been in power so far, China moved to the left on domestic politics, giving a greater role to the Party. In economic policy, we've seen it giving less headroom for the private sector. China has become more nationalist and more internationally assertive as a consequence of it becoming more nationalist. There are however opposing voices among the top leadership, and the open question is whether these voices can have any coalescence in the lead-up to the 20th Party Congress in 2022, which will decide on whether Xi Jinping's term is extended. If it is extended, you can say he then becomes leader for life. That will be a seminal decision for the Party.

What's your prediction?

For a range of internal political reasons, which have to do with power politics, plus disagreements on economic policy and some disagreements on foreign policy, the internal political debate in China will become sharper than we have seen so far. If I was a betting man, at this stage, I would say it is likely that Xi will prevail.



The Honorable **Kevin RUDD** served as Australia's 26th Prime Minister (2007-2010, 2013) and as Foreign Minister (2010-2012). Today, he serves as President of the Asia Society Policy Institute, a «Think-Do Tank» dedicated to using second-track diplomacy to assist governments and businesses in resolving policy challenges within Asia, and between Asia and the West. Asia Society has 13 centres worldwide, one of them in Switzerland. Mr. Rudd began his career as a China scholar,

serving as an Australian diplomat in Beijing before entering Australian politics. As Prime Minister, he led Australia's response during the Global Financial Crisis, when Australia was the only major developed economy not to go into recession. Mr. Rudd co-founded the G20 to drive the global response to the crisis.



Mark DITTLI is a journalist and author in Zurich, specializing in financial markets and global economics. He is CEO and editor of The Market, a new financial media platform that was launched in April 2019. The Market publishes in-depth analytical and background articles as well as interviews on companies, global industry trends and macroeconomic issues. From 2012 to 2017, Mark was the editor-in-chief of Finanz und Wirtschaft, Switzerland's leading financial newspaper. Prior to

that, he was the editor of the international section of Finanz und Wirtschaft and has spent five years as the U.S. correspondent of the paper in New York, covering economic and monetary policy as well as company issues. Mark has studied business economics in Zurich, journalism in New York and is a CFA charterholder. He is currently pursuing a Masters degree in history at the University of Zurich. Mark is married, has two children and lives in Zurich.

This interview has first been published on 29 September 2020 on [The Market](#). The views expressed here are solely those of the interviewee and they do not necessarily represent or reflect the views of the stars Foundation.

[stars insights](#) are exclusive contributions by business leaders and experts who scan the horizon to discuss geopolitical, economic, technological and further trends and developments which will impact society and business in the next few years.

[Impressum](#)