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Economics and Security in Collision: How to Envision Asia's Future?

Interview with Evan A. Feigenbaum*

China: The Evolution of its Political Economy

Le Banquet: We could start with a general question on the evolution of the political system in China after the upcoming Congress of the Communist Party and the appointment of a new team. Do you think, especially after the next President¹'s visit to the States and before the 18th Congress of the Communist Party, that there could be some changes in China's foreign policy and at home?

Evan Feigenbaum: The best way to start would be to focus on China's political economy, because the economy is, in many ways, at the centre of the major political debates in China. If you pick up a newspaper and you read about China now, the narrative is that China is a relentlessly successful country—and that is partially true. The part that's true is that China is emerging from the global crisis far stronger and earlier than almost any other major economy. But what is not true is that China is so successful that it isn't getting diminishing returns on its existing growth model, which has, for a couple of decades, been very focused on exports and on investment in fixed assets, and which is a very capital intensive model. It's important to start here because the current model, for all its successes, is unsustainable for a number of reasons. For one, those who are reaping the windfall of China's success are disproportionately concentrated in the corporate sector—they are business elites rather than ordinary Chinese, who actually get a negative return on their savings. And of course we know that there are as many as 100,000 social protests in China each year. So we know, too, that the leadership is tightening the screws internally in part because they fear the political consequences of social and economic dislocation. The system has a lot of capacity and resiliency but that won't be true forever.

And so one of the things that's especially interesting in China now is that there is real debate about how seriously and how far to rebalance this existing economic model. Ultimately, I think they won't be able to go as far as they hope—or as far as many foreigners hope—in large part because significant political obstacles stand in their way. If they really want to change the balance between production and consumption in China, to change the way capital is allocated so that it becomes more focused on households and not only the corporate sector, then you have to change a lot of things about the political economy of China. And in particular, you would have to break the nexus between the Party, state-owned enterprises, and the banking system. And that's going to be very hard to do politically because it will require, in the first place, that Chinese leaders pick winners and losers and not just foster a sort of balance among competing economic interests. I am, frankly, very skeptical that Chinese leaders have the boldness, political understanding, or the sense of the moment to really make the hardest and most difficult choices.

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¹ Xi Jinping.

So, over the next five to ten years, China is going to change a lot economically and its leaders are savvy enough to begin to foster rebalancing in a lot of ways. But there will be real constraints and limits.

What can they achieve? Well, for one, China will become more like a continental economy than an East Asian “tiger,” as infrastructure and development patterns move westward and integrate this large continental economy. Chinese industry is going to move up the value chain. There will be wage hikes in some places, especially along the coast. But at the end of the day, China’s political economy isn’t going to change as much as many foreigners hope—or even China’s leaders aim to in, for example, the design of their new 12th Five Year Plan.

What does that mean for Chinese leaders politically? Most likely, they will face much starker choices five years down the road that they do today. And they will have to take some tough decisions: do they want to double-down on rebalancing their economy, with all of the attendant consequences this will entail for unemployment as they force inefficient state enterprises off of subsidies and other benefits, or, on the other hand, do they want to just keep driving the current model forward and fight social and economic dislocation as they do today by simply muddling through?

Now, one problem they will have is that their economic calendar and their political calendar do not really align in a way that suggests a lot of potential for bold action. If you use the five year plan, which is their strategic blueprint for rebalancing the economy, as a metaphor for the economic calendar, well, look, the plan runs from 2011 to 2015. But the new leadership won’t be in place, and thus the political succession settled, before the end of 2012 or the beginning of 2013. So, by definition, the first two years of their five year plan, and all that it aims to do to foster rebalancing, cannot be bold. Nobody will want to take the kind of bold and risky decisions on the economy before the succession has settled down. And then we have to figure that Chinese leaders will need a year of consolidation politically, which takes you into 2013 and thus coincides with the third year of the plan. So at this point, you are at least three-fifths of the way into the plan without having been able to muster political consensus for bold action. So the bottom line is that they’re really going to be delaying a lot of the important economic decisions because the political stars simply won’t be properly aligned for some time.

At the end of the day, it could take a generation to achieve real rebalancing, and it certainly won’t happen by next Tuesday. In a lot of ways, the choices will become starker and starker for China because of the many imbalances now present in the economic system.

How Responsible Is The Global China in the World Affairs?

Le Banquet: These changes could also have dramatic consequences on the relationship between China and other countries, especially the United States. They will obviously influence the terms of trade, the capital markets and also oil and raw materials geopolitics. Each choice that China is making also has major consequences for other East Asian countries – Indonesia, Singapore, Malaysia, Vietnam, Japan, and others - because of the interdependence of their economies. How do you see these evolutions and could you elaborate also on the free-trade agreements signed by China and the ASEAN countries?

E. F.: Let me answer by focusing on three elements: geoeconomics, geopolitics, and what’s happening to global companies that are facing an increasingly difficult competitive landscape.

Now, on geoeconomics, I think we are entering a period of much greater tension with China on a whole range of economic issues. Many countries are now talking about global imbalances, China's place in resolving these, and the need for China, therefore, to rebalance its economy. But the problem is not that the Chinese refuses to rebalance. Indeed, as I just said in answer to your last question, the main idea behind the last two five-year plans, and especially the 12th Five Year Plan, is to move China toward a new growth model less dependent on exports and investment, and that will mean a China with a very different economic structure. The problem, then, is that China is rebalancing its economy on its own extremely deliberate and self-interested timetable. And China's timetable simply does not accord with the expectations and exhortations of other countries, particularly the United States.

So I suspect there will be a whole variety of related consequences on such policy issues as currency appreciation, trade practices, and the use of industrial policy instruments in China in ways that have been perceived internationally to tilt the playing field unfairly in favor of Chinese companies. The bottom line, I think, is that we are heading into a period of much greater economic tensions. These won't ride political and diplomatic relationships completely off the rails and there will be plenty of inbound and outbound trade and investment, of course. But there will be more trade conflict in general, especially between the United States and China, including things like anti-dumping suits.

Now, if you turn to geopolitics, I think part of the problem is that throughout the postwar period—and especially in Asia—the United States has exercised leadership by providing both security-related public goods and economic public goods. These security related public goods in Asia have included a network of five bilateral alliances and other security partnerships that the United States maintains, a forward deployed U.S. military presence, and, through these, the provision of public goods in, for example, the sea lanes on which countries like China have been able to free-ride. In the economic space, meanwhile, the United States has provided a crucial public good by serving, in essence, as the demand for Asia's export-oriented economies—and of course by keeping the American market open. The U.S. has also shown leadership on regional and global trade arrangements, especially in Asia but not only in that region.

But here is the central strategic reality of Asia today: security and economics are increasingly in collision. In Asia, the United States still provides the principal security-related public goods but, in the economic space, China is certainly providing the most important near-term economic public good, which is a pathway to recovery from the global crisis by swapping in Chinese demand as U.S. and European demand have lagged since 2008. Over the longer term, China may well aim to provide other economic public goods as well, including through increased direct investment in other Asian economies. In fact, trade and investment among Asian economies is an important trend here too: increasingly, Asian economic integration means that these economies will provide economic public goods to one another.

So one question that we're going to need to ask is how long economics and security can remain in collision in this way? Will China at some point seek to provide security-related public goods as well, and will this displace the United States? Will it mean that you can continue to have structures in which Asian countries are tacking toward the United States for security as the region's preponderant military power but simultaneously and increasingly rely on China in the economic space? I just don't think that's sustainable, so the United States is going to need to become much more active on the economic front, not least by getting its own fiscal house in order, bolstering its competitiveness, and beating back the forces of protectionism at home. Take a country

like South Korea. It's a very close military ally of the United States, and, if anything, Korea has moved closer to the United States strategically in the last couple of years, in part because of new fears engendered by the way China has handled its relations with North Korea. But in the economic space, the Korean economy has become much more closely tied to China, especially in recent years, and this is despite the promise of the Korea-U.S. Free Trade Agreement. South Korea's economy contracted something like 5.2 percent in the fourth quarter of 2008 amid an export slowdown caused by weak demand in the United States and Europe. But in 2010, South Korea grew by 6.2 percent. So, what happened? Well, it wasn't just because of the growth of domestic demand but also because Chinese demand, in some areas relevant to Korean exporters, swapped out for slack global demand. Australia is less of a manufacturing economy but the same dynamic plays out there: it is a resource exporter that now relies heavily on Chinese demand to power its growth. So with continued slow growth in the United States and amid austerity in Europe, China is increasingly providing economic public goods even as the United States and the West recede somewhat from that space in Asia.

So the questions will be, as I said, is this sustainable, and then, second, how do we cope with this collision between security and economics? What sorts of choices are these countries going to make?

Meanwhile, for at least a decade and an half, we have been talking about integrating China into the international system. But structurally China is already integrated. It is in the UN Security Council permanent 5, it's in the WTO, it's a member of every protocol on everything from ozone depletion to chemical weapons. So the question is no longer just how to "integrate" China, but how this more integrated China will exercise its power and pursue its own interests now that it has a seat at the top table. Will it preserve the status quo? Will it assume a role as a "responsible stakeholder" in the existing international system, or is it going to seek to use its economic leverage in ways that aim to change the basic underpinnings of that system and thus, in turn, create starker choices for countries like South Korea, the countries of Central Asia, India, and others, whose political interests and economic interests vis-à-vis China are diverging? Will it try to change the rules of the game on global and regional security or push for cooperative security arrangements? These questions remain very open.

Now, third, if we turn to companies, China poses an increasingly difficult competitive challenge, and that, I think, is going to become more intense. We used to speak about China as sweeping away old manufacturing industries in Europe and the United States, but that is not the sole issue anymore. Rather, China is moving up the value chain earlier and faster than many companies expected. Look at high-speed rail, which China aims to export even to OECD markets like Australia, and other high-tech sectors, for example. China is now competing in higher value added technologies in ways that will really challenge core competitive advantages in Europe, the United States, Japan, and elsewhere. So corporate relationships with China's economy will be neither "friend" nor "enemy" but rather an amalgam that we might as well call "frenemy." These companies' Chinese "partners" remain essential to expansion into China's domestic market but are simultaneously becoming competitors for global market share—and in some cases for market share in China too. That means the environment is becoming more complex and competitive. And this is happening in a world that is increasingly more complex generally. You have very complicated relationships among the big powers, where, for example, China and India agree on some things, disagree on others. China and Brazil have trade tensions, yet are cooperating in the BRICS and have similar views on, say, some aspects of climate

change on the demand side. It is just becoming a more complicated world. And so a lot of the way the world will be shaped depends on China's choices. China is certainly integrated in many ways and has become, from a structural standpoint, a "stakeholder" in the existing order. But will it define and exercise its responsibilities in a way that meshes with the interests of others?

Le Banquet: Do you think that there could be a role for the so-called G2, which is obviously not an institution like the G8 or even the G20?

E. F.: If by G2 you mean a strategic condominium, then forget it. There is not going to be a China-U.S. condominium. There could not be a G2 in that sense, and so a G2 is not a very useful concept.

Still, it is clear that the more difficult the U.S.-China relationship becomes, the more complicated relations between global powers generally will be. And so it's certainly true that a productive US-China relationship is essential to the smooth functioning of the international system. In many areas, China's choices are making that more difficult. And as I said, some elements of the relationship are becoming more competitive and more challenging.

Le Banquet: Many analysts say that China does not want to be a global player, even if it is a global actor, and to assume yet a political responsibility in the world affairs like the U.S. or even some European countries.

E. F.: Well, it's too early to say so. This debate about global responsibility has been thrust on China much earlier than China's leaders probably would have preferred. They prefer to pursue a self-interested course, and so all this talk about providing public goods internationally probably isn't too welcome.

I do think, though, that it's a debate that China can no longer avoid, simply because of China's scale. China's size, weight, and increasing global presence mean that China's behavior matters to what happens globally. And so China's domestic trade practices, or China's domestic technical standard-setting, or China's bilateral strategic relationships with Pakistan and others now have real meaning and for the global system. That means China can't shirk this issue of responsibility and simply pursue its self-interest, narrowly construed. And by the way, the whole debate about being a "stakeholder" is not an invitation to China to be one but a simple statement of fact. China is, quite literally, a stakeholder in the sense that China has both vulnerabilities to developments in the existing system and the capacity to shape it in a positive way. So the question, as I said before, is how it Beijing going to exercise that stake.

Now, there's also another way to look at the question of public goods provision. The postwar order was essentially set up by the victorious powers after the Second World War. And in many ways China has been a considerable beneficiary of that particular international order. Indeed, for of all the carping in Chinese newspapers and journals about American "hegemony" and American primacy, can you find a country that has done better in the last thirty years than China? China is now sitting at the top tables of international relations. And so American primacy has worked very nicely for China because China has, in fact, been able to take a free-ride on the provision of public goods by others, particularly in the security realm.

Now, the opposite of "stakeholder" is a free-rider. And so what the debate is about now is the extent to which China could or should step up and no longer take a free-ride. But that isn't just a question of who provides public goods but also of whether China and the United States define public goods differently. Just take the example of non-proliferation: the United States—and France, for that matter—negotiated civil nuclear deals with India. And partly in response, China pursued its own civil nuclear deal with Pakistan. So the Chinese argument has been, "well, you did your deal, so

we're doing our deal." But remember, the United States subjected its deal with India to the unanimous consent of 45 members of the Nuclear Suppliers Group and also subjected a related safeguards agreement to the consensus of 35 members of the International Atomic Energy Agency board of governors. Yes, the United States sought an exception to a prevailing norm, but it did so in a way that sought to reinforce the institutions of consensus. With Pakistan, China is trying to grandfather new reactors into an old understanding, and so it's not doing any such thing.

Now, this may or may not change because, the fact is, China has never had to make these kinds of political and strategic tradeoffs before. Another example is China's lending practices. China has traditionally had around a 4 percent voting share in the World Bank and the IMF. But after the Pittsburgh G20, a decision was made to revise these voting weights. So in the Bretton Woods institutions, China's share is going to grow. There's good news in that this means China is willing to be a literal stakeholder, and to expand its stake. But if you look at China's bilateral lending practices, they are not consistent with many of the lending practices of the multilateral institutions in which China's stake is now expanding. It's not that China does not do conditionality in its lending but that China's brand of conditionality—for example, when it drops \$8 billion into Turkmenistan, \$10 billion into Kazakhstan, or however many billion dollars into a country in Africa—generally employs a different brand of conditionality and tends to focus more on provisions such as “buy from China”, “source from China” or “employ Chinese labor”, whereas Bretton Woods conditionality has been more focused on macroeconomic fundamentals. China's bilateral lending practices don't really reconcile with the lending practices of the multilateral institutions in which its stake is now growing. And China will have to find a way forward as it tries to reconcile these contradictions. These are, quite frankly, questions China has never faced before. And they will get starker as the contradictions in Chinese policy become more apparent.

To me, that means it's too early to reach sweeping conclusions about the future of Chinese foreign policy because China has never exercised a role in the international space like the one it will exercise over the next five to ten years. Chinese leaders are a very conservative group of people and they love to sit on the fence. Asking them to make bold decisions, to have a sense of responsibility for the global system, to have deeply action-oriented partnerships with others, and so will require effort of a kind China has not traditionally demonstrated. So China will have to confront a lot of stark questions and, with Beijing's domestic focus, probably would prefer not to.

Le Banquet: There could be a change in Africa since many African leaders and the public are not aware of the way China is acting there and are asking for a more sustainable way of development. In this discourse, some Chinese leaders seem also to be conscious of the fact that, for reputational reasons but also if they want not to be rejected, they must change their approach.

E. F.: We need to be careful about that. The rising awareness in Africa is a good thing. But the question is not what China is building, but rather how it is building it. Some Chinese corporate practices have produced a backlash in African countries. And that's a reflection of labor and business practices, so corporate social responsibility could go a long way.

But more broadly, Chinese companies are going to have to think about risk management and risk mitigation in new ways. In some cases, Chinese companies are now looking to forge partnerships with major multinational companies in third countries. Why? Well, the traditional explanation is that this would give them access to technologies and skills—and that is certainly very often the case. But it's also true that Chinese firms in tough investment environment increasingly want to share the risks.

And this could produce behavior changes in Chinese corporate practices, and perhaps ultimately in Chinese government practices over time.

But we just haven't seen a lot of that yet, and so China is going to have to manage the backlash that these business and investment practices are producing – you had incident with Chinese managers arrested in Zambia, for instance. But the evacuation of more than 30,000 Chinese workers from Libya shows, I think, this newer risk dynamic at work. In a wide variety of ways, China is going to have to figure out how to operate in more volatile contexts and amid a more diverse array of risks as its global footprint expands.

Indian Uncertainties

Le Banquet: Let us turn to India's strategy. India often seems not to have an elaborated foreign policy. Of course, it appears to be mainly pragmatic and to avoid Chinese influence in its region and of course to prevent any reinforcement of Pakistan's role, which could explain its interest on Afghanistan. It's also trying to strengthen its nuclear capacity and on that peculiar aspect the alliance with America in George W. Bush's end of second term was a success. It is hesitating on the main concepts that it could communicate on the world stage.

E. F.: I think Indian foreign policy is very much in transition. You had the overhang of decades of Nehruvian non-alignment, but, to be frank, even before the end of the Cold War, India had a very pragmatic foreign policy in a number of ways. So this romantic notion of non-alignment was always not so straightforward in practice, and Indian foreign policy was sometimes very complicated, even after 1971.

But a couple of things have happened—*in* India, and also *to* India as the international system has changed. The first is the end of the Cold War, which has enabled an ongoing debate and rethink in New Delhi about how best to position India strategically. By the end of the 1990s, at the end of the Clinton administration, and then more definitively at the outset of the Bush administration, this helped to enable new opportunities to improve US-India relations as India reassesses its own strategic options.

Second, economic crisis in 1991 led to an initial burst of reform in India that has, over time, made the country much more relevant to global economic development—and relevant in a way that India simply was not in prior decades. And if you connect these economic developments to big strategic trends, growth has now allowed India to move out of South Asia strategically and into a global setting. India's trajectory has, for example, diverged utterly from Pakistan's in that respect. Both India and Pakistan are South Asian countries, but India is in the G20, it's on the Financial Stability Board, it's a player in global markets. And by the way, India is increasingly integrated into East Asia and the broader Asian economic space through free-trade arrangements and investment agreements. India has a free trade agreement with South Korea, with the Association of Southeast Asian Nations, with Singapore, and so on. So India is no longer just confined to the South Asian space strategically for the simple reason that its horizons and relevance widened economically. And that has made India more than just a South Asian actor. It is now an Asian power and a global player, with increasingly Asian and global interests. And that, to be frank, is entirely a function of India's capacity to generate and sustain rapid economic growth.

So a lot of the questions about the future of India will turn on economic issues. One question, for example, is the future trajectory of India's growth. India is growing very rapidly, it's true. It was hit by the global crisis but in more limited ways than most other major economies. Still, the Indian economy has slowed—it was just 6.1 percent

year-on-year in the fourth quarter of 2011, the slowest pace since 2008. And reform has mostly stalled out. Now, you can still get plenty of growth in India without a lot of reform. But that won't be true forever, and India has a big set of economic challenges ahead. These include weak physical infrastructure but also some big human capital challenges, like moving people from farms into cities, from the unorganized sector into the organized economy, from school to work, and so on. Half a billion people in India live on less than \$2 dollars a day. So India will need to sustain growth while addressing these economic issues, even as it seeks to leverage that growth into a new foreign policy trajectory that reflects the fact that it has transcended its South Asian geography.

Growth has given India a seat at the top table of international relations. But a critical question remains what the future of India's *economic* trajectory will look like, and how integrated it will become in terms of global trade, investment, supply chains, if it is going to be an even more meaningful player on the global stage.

Now, this doesn't mean that India can ignore South Asia. Its strategic focus has become more Asian and more global but it is still, to a very considerable extent, a prisoner of its unfortunate strategic geography—namely, the fact that it lies next door to Pakistan and in a region of mostly weak states. India just can't ignore what happens in Pakistan. And, after all, Pakistan remains a big obstacle to the very positive trajectory India has been on in recent decades. Put differently, the more things go downhill in Pakistan, the more India will become sucked into South Asian preoccupations on its borders. Remember that General Kayani, the chief of the Pakistan Army, has said that he is "India-centric." Well, that may be. But while there are certainly many in India who are Pakistan-centric too, that is becoming less and less true of corporate India, middle class India, and even, to some extent, the government of India. There are people in India who just wish Pakistan would disappear. It is a complicating factor for India's emergence. So, amid questions about Pakistan's stability, about terrorism that emanates from inside Pakistan, and so on, India simply does not have the luxury of ignoring its own strategic neighborhood. Unfortunately, the more these preoccupations become central to Indian foreign policy, the less India can really be a player on the Asian, much less global, stage.

Then, of course, there are the strategic choices India will need to make about its most important strategic relationships, and particularly with the United States. For a variety of historical, political, and ideological reasons, there won't be a formal alliance between India and the United States, like, say, the one the U.S. has with Japan. But based on a pure convergence of national interests, there should be a pretty strong trajectory in favor of a much closer U.S.-India relationship. This is a function of shared interests, in the first place, because India and the United States do have a set of mutual interests, including in assuring a favorable balance of power in Asia, a common commitment to democracy, and a shared interest in assuring sustainable global growth. Shared interests are pushing the United States and India closer together.

But common interests don't automatically translate into complementary policies. And that's, frankly, where the big tests will come. Take the issue of Iran. Despite differences that still exist between the U.S. and India, India has voted for findings of noncompliance with safeguards against Iran in the International Atomic Energy Agency board of governors. You have growing military coordination in the face of uncertainties about the rise of Chinese power, and so on. The two countries share uncertainties about the rise of Chinese naval power. And yet the United States and India will have to make some fundamental choices about whether and how to have a different kind of relationship, including whether and how to become more militarily interoperable, how to better coordinate security policies, and how to get onto the same page when it comes

to liberalizing global trade rules. Meanwhile, there is no question that the trajectory of India's other relationships is positive. It has diversified its partnerships in Europe and with Japan, for example.

Le Banquet: Nevertheless, the modernization process in India is slow and could be seen as an obstacle to a more sustainable growth. At the same time, 300 million people out of 1.2 billion suffer from starvation, the corruption remains permanent in all the levels and the transport system is still a real disaster. The last Asian games have even shown it to everybody.

E. F.: Sure, and in fact they know infrastructure is a big deal. But India is trying to do it with a model of public-public partnership that is very different from the Chinese model of huge state-led investments in fixed assets. And as I said earlier, human capital is a real challenge too.

But another thing to remember is just how federal the Indian system is. It's very difficult to generalize about this country. The system is so federal that you have great diversity from state to state. You can go from very poor states in the east to much richer states like Gujarat in the west or Andhra Pradesh or Tamil Nadu in the south. And by the way, you have poor states that are increasingly better governed, like Bihar and Orissa, while rich states in the south are plagued by uneven governance and corruption. So that points to the sheer scope of the challenge of corruption, which is endemic to the Indian system and has fueled a crisis of confidence in Indian institutions among large swaths of the populace. Meanwhile, federal politics in New Delhi has been paralyzed, and that, in turn, has paralyzed the reform agenda on everything from tax and pension reforms to certain changes to foreign investment rules. This could, I think, become very problematic for India in time, but at least you have some very dynamic and increasingly well-governed states.

Pakistan: A Troubled Future

Le Banquet: Let's turn to India's neighbor: Pakistan. It has obviously to address security issues with the rise of radical Islamic groups, sometimes seemingly protected by the Inter-Services Intelligence (ISI), and for its neighbor states there are huge security threats since Pakistan now has a nuclear capacity. But, without mentioning corruption, this country is witnessing the collapse of its political power and a serious crisis of its ruling class which is not trustable and able to meet the challenges that the country is facing. Could we nonetheless envision positive changes in the next foreseeable future?

E. F.: Well, you're right to focus first on security because the challenge from extremist groups is no longer just a problem in the tribal areas but has extended into cities in Punjab and Sindh, like Lahore and Karachi. The Pakistan Army has had some successes but it hasn't achieved a "global" success against the problem in Pakistan writ large.

A second issue is the quality of governance and the weakness of Pakistani institutions. And a third is the fiscal situation and the lack of a credible growth strategy. This has really approached a crisis in recent years because Pakistan's fiscal fundamentals are very poor. It has depended on external sources of revenue, not least the IMF and the United States. And it has sought to address the problem domestically largely on the revenue side rather than through the kind of expenditure cuts that would ultimately have, I think, a bigger impact on the problem. They have focused, for example, on a Reformed General Sales Tax as a way to close some of their fiscal gaps, but what you ultimately need is a sustained basis for generating economic growth and, in the bargain, significant expenditure reforms, especially to agriculture and defense

spending, both of which are now untouchable for political reasons. So how do you address this fiscal gap amid so many political obstacles and without an enduring strategy for growth? I'm not very optimistic.

The Rise of New Asian Powers

Le Banquet: If we consider Southeast Asian countries – Indonesia, Thailand, Vietnam, Malaysia, Singapore - could they have in your opinion their own foreign policy and their own strategy in the next coming years? Could this strategy change the equilibriums in Asia?

E. F.: Well, you have countries like Indonesia, which are increasingly breaking out of an ASEAN box by pursuing more assertive bilateral diplomacy, including with the United States. And one question is what that will mean for the future of ASEAN cohesion? Then, of course, you have to ask what that in turn will mean for Asia writ large, because the process of building institutions and architectures in Asia has, after all, been very ASEAN-centric.

Now, ASEAN itself has a lot of structural weaknesses, not least the fact that it operates on the principle of consensus rather than majority decision-making. So weak chairs like Laos or Cambodia cannot drive ASEAN policy the way a stronger chair can. And ASEAN has had a lot of trouble assimilating Burma to ASEAN ways. This is going to be a particular challenge as Burma takes on the ASEAN chair in 2014. I suspect the coherence of ASEAN will increasingly be tested.

Then, there is the China question, because China is going to pose some of the same structural issues in Southeast that we discussed earlier as we talked about South Korea and Australia. Nobody in Southeast Asia wants to pursue a confrontational policy with China. Nobody. But again, economics and security are in collision in various ways. For many countries around China's periphery, China's weight and China's behavior—for example the way Beijing threw its weight around in 2010—especially when combined with broader uncertainties about how China intends to exercise its power, have led to a tacking toward the United States and enhanced coordination with each other as a hedge against China's growing strategic weight. China has simply scared its neighbors silly. We could talk, for example, about Vietnam and other countries, where the United States is now pushing on an open door as it contemplates new security cooperation. But in the economic space, China is playing an absolutely central role in stitching Asia region together on trade, investment, and in various dimensions of the supply chain.

Le Banquet: There are some paradoxes related to what you mention: in Vietnam for instance, the Chinese phone companies are controlling 80% of the market, with possible huge consequences if a major crisis occurs.

E. F.: But Southeast Asian countries could turn out to be among the biggest beneficiaries of economic change in China. The rebalancing agenda that is at the center of China's 12th Five Year Plan, for example, will have major consequences region-wide. As China moves up the value-added chain, and as labor costs rise in coastal China, Southeast Asian countries will be in a position to seize new opportunities at the bottom of the supply chain. Look at a country like Vietnam, where this could be a real opportunity: rising labor costs in coastal China will compel some firms to shift their production to interior China, but others will choose Indonesia or Vietnam. And these countries will become much more attractive destinations for global capital if they make good choices about their macroeconomic and investment fundamentals.

For resource-dependent economies like Indonesia, too, that will be a good thing because it can help to diversify the economic base. This means that, ironically, some of

China's erstwhile strategic rivals in East Asia could be among the biggest winners of China's success in making an economic transition. Thailand is one country that could win, because its intellectual property protection is stronger than Vietnam's. And this dynamic could apply to India as well: India has lagged in manufacturing but it could pick up some of these benefits as a side-effect of the growth of manufacturing in south India and the integration of southern Indian states into supply chains in Southeast Asia. That's another reason Indian trade arrangements with Asian countries could matter a lot.

The bottom line is that economic relationships between Southeast Asian countries and China are increasingly well integrated. And as I said at the outset, economics and security are now broadly in collision. That is the central strategic reality of Asia today, and it's not necessarily a sustainable one.

As for the United States, well I hope it can adapt itself by exercising some leadership on regional and global trade arrangements. Why cede that space to China? For instance, it took two years for the Obama Administration to move forward with a trade agreement with South Korea that was negotiated by the prior administration. The administration has been sitting for more than three years on bilateral investment treaties, which it could negotiate with India and China. Asia just isn't stand still and waiting for the United States. And Asians aren't only making free-trade agreements but also investment agreements and agreements on technical standards.

Japan Between Asian Community and the U.S.

Le Banquet: My two last questions are regarding Japan. The first one concerns the economic situation of Japan. For some years, its economic power has seemed to diminish, especially if we consider the recent difficulties for many companies to innovate as they did before and as some countries do now. The second issue is the question of the relationships with the United States and of the main alliances Japan should develop. Of course, the main U.S. alliances in the region are with Japan and South Korea. But there is a growing American interest in other countries, as Barack Obama's long trip to Asia in November 2011 has shown. Could Japan suffer for not occupying the central place – if it's right to say that it did so – in American strategy, and could it have the temptation to play a less cooperative game and to increase its military forces independently if it begins to feel less secure with the guarantees brought by the U.S.?

E. F.: Japan is a pretty large economy, so I wouldn't take for granted that it will become less relevant simply because China is becoming a bigger economy. Japan has big debt issues, but that's mainly a problem of domestic debt. Meanwhile, China has its own debt problems. And in fact, China's debt problems are really the inverse of the United States: the U.S. is dealing with massive consumer debt while Beijing is dealing with massive producer debt.

Now, many people say Japan faces a crisis of confidence in its political class and in its political institutions. And it's true that Japan has experienced a long period of slow or no growth. But remember that the political and social fabric of Japan has not really frayed despite all the problems. Imagine if you had such a long period of slow or no growth in China? In China, you would have huge social dislocations and political unrest. This just hasn't happened in Japan, and that suggests a high degree of underlying stability. And Japan has a lot of strengths. It is the third largest economy in the world. The yen, unlike the renminbi, is a global reserve currency. Japan is still a large donor of foreign assistance.

The challenge for Japan will be, in part, to confront a broad set of strategic choices: What kind of country will Japan be on the global stage? How will it achieve and sustain domestic consensus around new growth fundamentals?

Still, Japan remains an extremely important actor globally. And Japan is still the basis of American strategy in the Pacific. If you think about the first half of the 20th century, the United States became a partner with China against Japanese expansion. But in the postwar period, the American alliance with Japan has produced extraordinarily positive results for both countries—and for the Asian region, at a time when there have been considerable uncertainties, including now from China.

Of course, there are some tough issues ahead for the alliance. A first question is whether the United States and Japan can reach discrete agreement on some aspects of the American presence in Japan. And more broadly, when you turn to their many common interests, especially complementary security interests, Washington and Tokyo will need to adapt their alliance to a fast-changing dynamic within Asia. And they will need an affirmative vision for the alliance. After all, at the end of the day, an alliance can't simply stand against something but needs to stand for something as well.

The U.S. and Japan will also have to address the tension between trans-Pacific and pan-Asian institutions. On a number of issues related to investment, trade, and even technical standards, Japan has joined with other Asian countries to act on a pan-Asian basis without the United States. Many in Japan stress this pan-Asian dimension, and this traces its roots in part to the post-1997-1998 crisis period when the United States was widely perceived in Asia to be aloof from the challenges of the financial crisis. So Japan has simultaneously pursued both pan-Asian and trans-Pacific elements of its foreign policy. And as allies, this means the United States and Japan will need to tackle some very fundamental issues about how to reconcile these and thus deal with the future of Asian architecture.

Le Banquet: In some scenarios for the next thirty years, some authors imagine that the relationships between the United States and Japan will weaken, especially if there is a come-back of some nationalist forces in Japan, and that there could even be a real conflict between these two powers? What is your opinion about these approaches?

E. F.: Well, for Japan, the two main strategic issues are its future growth trajectory and uncertainties about how China will exercise its power. But in any case, Japan and the United States are likely to remain close security partners.

Interview by Nicolas Tenzer in Washington DC