

REVISED DRAFT

THE G-2 CHIMERA: FUSION OR ILLUSION?<sup>1</sup>

Harry Harding  
Dean  
Frank Batten School of Leadership and Public Policy  
University of Virginia

The title and subtitle of my talk, “The G-2 Chimera: Fusion or Illusion?,” may require some explanation. The title refers to two concepts – G-2 and “Chimerica” – that embody, in different ways, the proposition that the bilateral relationship between the United States is uniquely important – that, as Hillary Clinton wrote during the 2008 presidential election campaign, it is “the most important bilateral relationship in the world in this century.”<sup>2</sup>

The concept “G-2” is associated most prominently with C. Fred Bergsten, the director of the Peterson Institute of International Economics.<sup>3</sup> This concept focuses on the roles of China and the United States in the broader international trade and financial system, and their unique ability to set the agenda and possibly forge agreements on a wide range of international issues. China and the U.S. form a G-2, according to Bergsten, because they are the world’s two largest economies, and because they represent the interests of the developing and developed worlds respectively.

The term “chimera,” in turn, is a reference to the etymology of the concept of “Chimerica,” which in turn is most closely associated with the Harvard historian Niall Ferguson and, more recently, with author Zachary Karabell.<sup>4</sup> This second concept focuses less on the two countries’ role in the world than on their high degree of mutual integration, despite their differences in structure and values, such that one country’s economic circumstances strongly influence the other’s. The term is a clever pun, since the original word, “chimera,” refers to the mythological creature that is composed of parts from genetically different animals: originally the head of a goat, the body of a lioness, and the tail of a snake. And of course Ferguson’s revision, “Chimerica,” modifies that word to refer to China (“Chi”) and America (“merica”).

The subtitle of my talk, “Fusion or Illusion,” then asks whether the basic proposition common to both concepts – that the U.S.-China relationship is a uniquely important and a uniquely promising pairing -- is likely to be valid. After all, in modern genetics, the term “chimera” refers to a true hybrid – a real animal that comprises genetically distinct cells. But in common English usage, “chimera” retains its original meaning as a work of fiction, a creature of the imagination, rather than something real.

In short, what do concepts like the “G-2” say about the relationship between China and the U.S.? Are we talking about two countries that constitute the most economic and political actors in the contemporary world? Or are we talking about what has become a single integrated economy, such that the health of one depends fundamentally on the health of the other? And does either of these premises suggest a genuine hybrid or fusion, created by some new form of international genetic engineering? Or is it, like the original chimera, an illusion, not based on any reality?

## The G-2

### The two largest economies

Fred Bergsten's notion of the G-2 is a direct and obvious allusion to the earlier notions of a G-7 or G-8. It implies that because China and the U.S. are the two world's largest economies, they have a unique ability and responsibility to manage the world economy and may form a more appropriate grouping for economic governance than the G-7 or G-8, or even the G-20. Although, as we will see, this is only one basis for Bergsten's argument for viewing the two countries as a group of two, it is the version of the G-2 that is most common in policy circles today.

It's certainly true that the U.S. and China are the world's largest economies, at least on the basis of purchasing power parity (PPP). They are also the world's two largest trading nations. This would seem to create a plausible reason to propose that Washington and Beijing exercise some kind of global economic leadership. The fact that, in the aftermath of the global financial crisis, the two countries have also formulated and implemented what appear to be the largest and most effective economic stimulus packages also underscores their relative importance.

However, although the two countries are the world's two largest economies, their share of world GDP (again in PPP terms) is not as great as those rankings might suggest. According to the World Bank, total world GDP in 2008 was \$69,697,642 million (or \$69.7 trillion). Of this, the U.S. accounted for \$14.2 trillion, while China accounted for about half as much, or \$7.9 trillion. The next two countries, Japan at \$4.4 trillion and India at \$3.4 trillion, were together about the same size as China. And then came six other countries – Germany, Russia, the U.K., France, Brazil, and Italy, with economies ranging from \$1.8 trillion to \$2.9 trillion, which together were about the same size as the United States.

So it's hard to assert that the U.S. and China dominate the world economy, even though together they produce almost one-third of global GDP. I find it more value to argue that the top ten countries dominate, responsible for 62% of GDP (\$43.2 trillion of \$69.7 trillion). And if one wanted to single out subgroups, it would make as much sense to see the U.S. as a G-1, or the U.S., China, India, and Japan as a G-4, as to see China and the U.S. as a G-2.

The fact that the U.S. and China do not dominate the world economy as thoroughly as talk of a G-2 helps explain the fundamental political reality that other large countries are reluctant to cede global economic leadership to the U.S. and China. If the G-8 has been expanded to the G-20, how can it now be shrunk back to become to the G-2? This is why, in one version of his argument, Bergsten has argued that the two countries “must...operat[e] as a de facto ‘G-2’ without ever announcing or even acknowledging its existence.”<sup>5</sup>

Nor does China appear eager to take on this role. Chinese analysts seem flattered that some in the U.S. would regard them as equal to America as a member of a G-2, giving it a status above all other nations, but they seem reluctant to take on the special responsibilities or encounter the likely resentments that accepting that role would entail. And when China becomes powerful enough to do so, would its leaders be willing to maintain a special relationship with the United States – especially one that many Chinese believe is intended to limit their freedom of action?

At the point at which it was reasonable for China to form a G-2 with the U.S., in other words, why would it agree to do so?

#### The established power and the rising power

A second version of the G-2, also contained in Bergsten's original vision, stresses the differences in the values and ambitions and China and the U.S., rather than the similarities in their size. Bergsten noted that, as a "poor, significantly nonmarketized, and authoritarian" country, China seemed reluctant to "accept the systemic responsibilities that should ideally accompany superpower status." Indeed, he went on, "Chinese recalcitrance seems to be increasing rather than decreasing over time." The risk, again to quote Bergsten, was that China would propose "alternative structures for which China can be present at the creation" – structures in which China would presumably play a greater role, and that would be organized around quite different values than those associated with the United States. Bergsten in particular mentioned low-quality free trade agreements and non-conditional foreign aid packages, but the problem could well apply to other institutions and issues as well.<sup>6</sup>

Part of the purpose of Bergsten's concept of the G-2 was, therefore, to encourage China to accept existing international norms and institutions, rather than to challenge them or replace them, by offering China a unique partnership with the United States. Where the Bush Administration, through then Deputy Secretary of State Robert Zoellick, had offered China the position of "responsible stakeholder" in the an international order led by the United States, Bergsten was offering China something more – something that he described as a "true leadership position" in that order. More specifically, Bergsten argued that the existing bilateral Strategic Economic Dialogue (which has now evolved into the Strategic and Economic Dialogue) could serve as the mechanism through which that shared leadership could be exercised. Thus, in Bergsten's vision, the G-2 was only in part a recognition of an existing reality: the size and dynamism of the Chinese economy. Equally, if not more, important, its purpose was to create a new reality: a China that would cooperate with the United States by offering it shared leadership.

#### The largest developed and developing countries

Also embedded in Bergsten's concept of the G-2 was still another, slightly different idea. The U.S. and China could appropriately share global leadership as a G-2 not only because they are the world's two largest economies but also, and perhaps even more importantly, because they are the world's largest developed and developing countries respectively. If China and the U.S. could reach a consensus on key global issues, that consensus would therefore be able to attract – some would even say compel -- support from others. So far, the issues in question have been primarily trade and climate change, but in the future could also include investment, energy security, development assistance, and possibly others as well. So, for example, if the U.S. and China could reach a consensus on climate change, they would immediately set the agenda for the Copenhagen Conference and for subsequent meetings on the agenda.

This version of the G-2, like the others, is rooted in an important reality. It's true that China and the U.S. are both successful globalizers, and that this gives them more common perspectives than the U.S. would have with more autarkic or protectionist economies (or, for that matter, than it would have had with China itself before the early 1990s). But they still remain at very different levels of development – and of course they have different political and economic systems, which in turn are rooted in different values. That gives them different perspectives on many, if not all, of the global issues listed above.

On climate change, for example, each holds that the other – and the larger group of countries it presumably represents – bears the greater responsibility for the problem. Chinese say that the U.S. has the greater responsibility, because it has historically introduced more greenhouse gases into the atmosphere. Americans say that China has the greater responsibility, because it is now emitting more greenhouse gases into the earth's atmosphere, and will emit even more in the future. The outcome of the December 2009 Copenhagen conference on climate change shows how difficult it can be for China and the United States to reach a constructive agreement on the issue, despite the confident predictions by some observers that the issue would be the basis for a natural partnership between the two countries. Instead, they could only agree on a document that required no binding goals from developing countries, set no specific emissions targets for the developed world, and contained no reference to negotiating a more binding treaty in the future. And even this minimal achievement involved negotiations between the U.S. and China that were described as highly acrimonious.

Or take the global flow of foreign investment. As I understand it, the negotiations between Washington and Beijing over a bilateral investment treaty addressed the issue from two very different angles. The U.S. wanted to reduce the limits on foreign access to direct and indirect investment opportunities in China. The Chinese wanted to gain equal access as any other foreign investment to investment opportunities in the U.S., even in deals that involve advanced technology and critical infrastructure. In effect, Beijing has argued that if British Petroleum was eligible to buy Union Oil (UNOCAL), then the Chinese National Overseas Oil company (CNOOC) should have been eligible to do so as well. The U.S. has countered that, if CNOOC were eligible to buy UNOCAL, then UNOCAL should have been eligible to buy CNOOC. As in trade, China has demanded most-favored-nation status, whereas the U.S. has been more interested in acquiring greater access to the Chinese market.

Moreover, even if the two sides were able to agree on these difficult issues, they might not find so easy to bring other developed and developing countries along with them. This could happen if consensus reached by China and the U.S. lagged behind what other developed countries desired. (For example, the U.S. and China could conceivably agree on a "deal" on climate change that required few commitments from either country, disappointing the Europeans and the Japanese – basically the outcome that was achieved at Copenhagen.) Or it could occur if the consensus reached by Washington and Beijing went beyond what other developing countries would accept. (For example, China might now be willing to accept market-opening measures that other large economies, such as India, would find objectionable.)

## The P-2

Finally, there is a fourth version of the G-2 argument that is not directly relevant to a discussion of U.S.-China economic relations, but that still warrants at least passing mention. I call it, not the G-2, but the P-2, proposition: that China and the U.S. are the world's most important military and geopolitical powers. In other words, just as the G-8 should really be seen as a G-2, so should the UN Security Council's P-5 really be regarded as a P-2, since the U.S. and China are so much more important than the other three permanent members of the body. And just as some argue that, as the world's largest developed and developing countries, if China and the U.S. can reach a consensus on global issues, they can set the agenda for the rest of the world, so too do others argue that, if China and the U.S. can work together as a concert of powers, they can assure stability in the Asia-Pacific region and can virtually impose solutions on major sub-regional issues both inside the region (e.g., North Korea) and elsewhere (e.g., Iran)

Again, the idea of a P-2 is rooted in an important reality. Increasingly, China and the U.S. share common interest in geopolitical stability, counter-terrorism, and non-proliferation. And together, they have levels of comprehensive national power that can encourage – if not compel – solutions to key global and regional problems.

However, it is equally true that the two countries also have different interests when it comes to specific issues. For example, their common interest in the denuclearization of North Korea and Iran counterbalanced somewhat offset by China's interests in the stability and survival of the North Korean regime, and access to Iranian energy supplies – neither of which is an interest shared by the United States. In addition, the two countries have quite different preferences as to international strategy. Washington is far more willing to envision the use of economic and military sanctions than is China, and far more willing to engage in humanitarian intervention that is unwelcome to the government of the country in question. As I have argued elsewhere, this reflects China's preference for a set of international norms that reflect the Westphalian values of equality, national sovereignty, and territorial integrity, whereas the U.S. prefers a post-modern international system that can impinge on the sovereignty and territorial integrity of states that violate post-modern norms of non-proliferation and human rights.

These differences are significant in themselves, in that they limit the ability of the U.S. and China to agree, as a P-2, on how to handle major political and security issues. Equally important, they exacerbate the mistrust that already characterizes the relationship between a rising power and an established power that have a recent history of conflict and competition and that have very different political systems.

And, of course, the other members of the existing P-5 do not want their positions diluted by the creation, however informal, of a P-2. And other major rising powers – including Brazil, Germany, India, and Japan, want the UN Security Council to include them. Each of them also has significant resources – military, economic, diplomatic – to bring to the work of global leadership, with some potentially playing critically important roles on particular international issues.

Moreover, there are other stakeholders who would resent and even fear a Sino-American strategic condominium. This would include many of America's Asian allies, who are important partners in the U.S. hedging strategy against China that, in turn, stems from the mistrust I have just mentioned. Most of them take what I call the "Goldilocks" approach to U.S.-China relations: they want the relationship to be not too hot, not too cold, but "just right."

So, just as the G-7 is more likely to be replaced by a G-20 than by a G-2, so is the P-5 more likely to evolve into a P-9 than to devolve into a P-2.

### Chimerica

As noted above, the concept of Chimerica, associated with Niall Ferguson, is slightly different than Fred Bergsten's concept of the G-2. The G-2 singles out China and the U.S. because of their potential role in the international community. Chimerica singles them out because of their high degree of economic interdependence. In fact, the title of a recent book by Zachary Karabell, *Superfusion*, pushes the concept even further, saying that the level of interdependence is so great that the two countries have been "fused" into "one economy." However, despite this underlying similarity, Karabell and Ferguson interpret the high degree of interdependence between China and the U.S. in two quite different ways, highly positive and highly negative, respectively.

### Healthy hybrid or dangerous monster?

Zachary Karabell takes an optimistic view of the growing integration between China and the U.S. The "fusion" of the Chinese and American economies creates, in his view, considerable commercial benefits for both Americans and Chinese: greater availability of consumer and capital goods, and greater opportunities for investment. Moreover, because the U.S.-China economic relationship also benefits the rest of the world as well, since American imports from China also involve the export, to China, of components and raw materials from many other countries. That explains the second half of the subtitle of Karabell's book, which posits that "the world's prosperity" depends on the fusion of the Chinese and American economies.

In addition, according to Karabell, the economic integration of China and the U.S. produces greater requirements for economic cooperation and thus introduces greater stability into a previously volatile U.S.-China relationship. The two countries' commercial and financial economic interdependence has created a kind of "mutually assured destruction" reminiscent of the Cold War, except the mutual destruction would be economic, rather than nuclear, and the interdependence generates positive cooperation to enhance mutual gain, rather than merely negative cooperation to prevent nuclear war.

Karabell's positive view of the economic and political implications of Chimerica leads him to argue the economic relationship between the two countries should be deepened and institutionalized. In a recent essay, for example, Karabell has proposed that the U.S. and China

form a “joint central bank” to “determine interest rates and currency pegs,” and that the U.S. stop reviewing proposed Chinese investments in the U.S. for their security implications.<sup>7</sup>

In contrast, Niall Ferguson focuses on the unhealthy aspects of the relationship. His argument is not just that the two economies are interdependent, but that their interdependent relationship is imbalanced. The U.S. has been running a continuous trade deficit with China since the mid 1980s, while China has been accumulating excessive levels of U.S. dollar reserves. This imbalanced, “symbiotic” relationship, as Ferguson calls it, reflects the deeper problem that China has a far higher national savings rate than the U.S. These imbalances were an ultimate cause of the current global financial crisis.<sup>8</sup> And unless they are reduced, there will be a continuing risk to the stability of the international financial order. A continuing American trade deficit will imperil the value of the U.S. dollar, threaten higher interest rates, and thus jeopardize the sustainability of American economic growth. Conversely, a continuing Chinese surplus will create the a risk of asset bubbles and inflation at home and abroad, due to the huge amount of liquidity generated by the buildup of China’s dollar-denominated reserves. The U.S. and China need to cooperate in managing their interdependent economies, but the reason to do so is not just to generate mutual gain, but to prevent mutual loss. Indeed, the ultimate objective, according to Ferguson and his colleague Moritz Schularick, should be to either kill this “economic monster” or else allow it to die the “peaceful death it deserves.”<sup>9</sup>

#### But does Chimerica really exist, or can it be created?

But to what extent does the chimera-like relationship between China and the U.S. actually exist? Of course the two countries are interdependent, but perhaps not to the degree that much popular discussion seems to assume. Once again, a focus on rankings and an examination of shares produces two quite different analyses.

Rankings of the two countries’ mutual importance to each other do suggest that China and the U.S. have become highly interdependent. In 2008, the U.S. was China’s number one trade partner, while China was America’s number two trading partner. As with the concept of the G-2, ranking, or relative size, has helped produce the concept of Chimerica. At the same time, the degree of interdependence is further deepened by the nature of trade – by the fact that it is generated by highly sophisticated transnational production and consumption networks centered in the two countries – and by the associated capital flows that both generate the trade (in the form of direct investment) and are produced by the trade (in the form of China’s increased holdings of U.S. dollar denominated assets).

But each country’s share in the other’s global trade patterns is less than the rankings might suggest. As noted, last year China was America’s number two trade partner, but it accounted for only 12% of America’s global trade. Last year the U.S. was China’s number one trade partner, but the U.S. accounted for 13% of China’s global trade. The numbers are obviously much higher for certain sectors and for certain regions of both countries, but these national statistics would surprise many of those who believed that the two economies are joined at the hip.



The same is true of China's holdings of U.S. Treasuries. To hear many commentators tell it, when Barack Obama visited China, he was visiting America's banker. In fact, as of the end of August, China held less than a quarter of American sovereign debt held by foreigners: \$797 billion of \$3,449. (And, of course, around half of U.S. sovereign debt is held by American investors, making them, not China or Japan, the U.S. government's most important lender.) Indeed, Obama actually visited two of America's bankers on his visit to Asia, since Japan holds another \$731 billion in U.S. Treasuries, or 22% of the total. From a financial perspective, perhaps what we are witnessing is not "Chimerica" but "Chijapica" – a tripartite image that might be more faithful to the original vision of a chimera as part lion, part goat, and part snake.

And to what degree does the interdependence of the Chinese and American economies produce pressures for even greater fusion? Interdependence has almost certainly stabilized the overall bilateral relationship to a significant degree, for all the reasons mentioned above. But it also has long generated complaints from each side that the other is benefitting more – in other words, a disagreement about how to assess the relative gains to the economic relationship. And it is also producing a debate over responsibility that parallels the debate over climate change: the two sides agree that there is a dangerous problem that needs to be addressed, but differ over who is responsible and what should be done.

Karabell laments that this resistance to the further integration of the two economies is irrational. But rational or not, the opposition limits the possibility that U.S.-China economic relationship will achieve a high degree of "fusion." The term might be appropriate if they two countries had formed an economic union, which is the highest institutional form of economic integration, or even a common market, which is one step less. But they do not even have a free trade agreement and, given the difference in economic structure and level of development, it is difficult to imagine that they will be taking this first step any time soon. Even Ferguson's recent proposal that the U.S. promise a continued commitment to free trade in exchange for Chinese promise to revalue the *renminbi* will be difficult to implement.

### Conclusion

My task was to give a charge to this conference by introducing the concept of the G-2. I've done so by setting out my understanding not only of the concept that China and the U.S. play uniquely important roles in the international political and economic systems, but also of the closely related, yet not identical, idea that they form a highly integrated economy known as "Chimerica." I've noted that each of these two concepts, in turn, has spawned several variants. I've identified four versions of the G-2, and two versions of "Chimerica." The G-2 idea is based variously on the notions that China and the U.S. are the world's two largest economies, that they have different views of the international economic order, that they can represent the developing and developed worlds respectively, and that they are also uniquely key to the management of global and regional political and security matters. The concept of Chimerica means that the Chinese and American economies have become highly interdependent, but one version sees this as a positive development that should be deepened and institutionalized, while another version sees it as troubling phenomenon that should be significantly redefined as soon as possible.

But how accurate are these various descriptions of the U.S.-China relationship? My own view is that these two sets of idea carry important insights, but like so many concepts that capture the public imagination, they are subject to quite different definitions, oversimplify a complex reality, and imply controversial policy implications that are an uncertain guide to action.

My conclusion is that the depth of economic integration beyond mere trade and investment flows (the basic phenomenon behind the concept of Chimerica) is likely to be limited. To the extent that the economic integration of the two countries has occurred, I find Ferguson's concern about the unhealthy nature of the two countries' financial interdependence to be more persuasive than Karabell's more benign portrait.

I have also concluded that the degree to which U.S. and China occupy singularly important places in the global political economy (and thus constituting a G-2) is likely to be limited. True, there will be some issues (such as climate change) where China and the U.S. will together form the biggest part of the problem, and others (such as the North Korean nuclear program) where they might together provide the most important elements of a solution. But even here, China and the U.S. will not monopolize either the problem or the solution. Other actors, both other large developed economies and other major emerging markets, will be critically important as well: Japan and South Korea on the North Korean issue; India, Brazil, the EU, and Japan on climate change. This will be equally, if not even more, true for other major regional and global issues. And, as we have seen on issues ranging from climate change to the Iranian nuclear program, the degree of policy cooperation that they will be able to achieve may not be as great as the proponents of the G-2 would hope.

And from a strategic perspective, concepts that single out one country – China – to occupy a uniquely important place in U.S. foreign policy is not necessarily wise. Indeed, the concepts of a G-2 and a Chimerica represent the most recent example of our historic obsession with China, whether as partner or rival, sometimes to the neglect of other important international actors and problems. By contrasting the G-2 with the G-20 and the P-5, and by pointing to the role of Japan and other major actors (including American domestic investors) as buyers of U.S. Treasuries, I've tried to suggest that concepts that continue to limit our focus to China may blind us to the challenges and opportunities that lie beyond Beijing.

For all these reasons, then, my conclusion is that the U.S.-China relationship forms a very incomplete hybrid -- the U.S.-China chimera may therefore be more illusion than fusion.

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<sup>1</sup>This paper represents a revised version of remarks presentation originally prepared for presentation for "G2 at GW": The Second Conference on China's Economic Development and U.S.-China Economic Relations, sponsored by the Institute on International Economic Policy, Elliott School of International Affairs, The George Washington University, November 20, 2009.

<sup>2</sup> Hillary Clinton, "Security and Opportunity for the Twenty-first Century," *Foreign Affairs*, 86:6 (November-December 2007), pp. 2-18. This presumably replaced America's relationships with

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Britain, the Soviet Union, and Japan, which at various points were described as the most important bilateral relationships in the world in the last century. To paraphrase Tom Wolfe's brilliant line about trendy New York restaurants in *Bonfire of the Vanities* ("this week's restaurant of the decade"), the U.S.-China relationship has become this decade's relationship of the century.

<sup>3</sup> On the G-2, see C. Fred Bergsten, "A Partnership of Equals: How Washington Should Respond to China's Economic Challenge," *Foreign Affairs*, 87:4 (July-August 2008), pp. 57-69; and Bergsten, *Pacific Asia and the Asia Pacific: Choices for APEC*, Policy Brief PB09-16 (Washington, DC: Peterson Institute for International Economics, July 2009).

<sup>4</sup> On "Chimerica," see Niall Ferguson and Moritz Schularick, "'Chimerica' and the Global Asset Market Boom," *International Finance*, 10:3 (2007), pp. 215-39; Ferguson and Schularick, "The Great Wallop," *New York Times*, November 16, 2009; Zachary Karabell, *Superfusion: How China and America Became One Economy and Why the World's Prosperity Depends On It* (New York: Simon and Schuster, 2009); and Karabell, "On China Trip, Lose the Old Baggage," *Washington Post*, November 8, 2009.

<sup>5</sup> Bergsten, "Pacific Asia and the Asia Pacific," p. 3.

<sup>6</sup> Bergsten, "A Partnership of Equals."

<sup>7</sup> Karabell, "For China Trip, Lose the Old Baggage"

<sup>8</sup> Ferguson and Schularick, "'Chimerica' and the Global Asset Market Boom."

<sup>9</sup> Ferguson and Schularick, "The Great Wallop."