

**Australia-China Relations Institute**

**Prime Ministers Series: Keating and China  
The Hon Paul Keating in conversation with Kerry O'Brien**

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**Transcript, E&OE**

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**Kerry O'Brien:** I do want to start with some reflections on your time in office and the thrust of your foreign policy focused so much on the region, but that's only a part of this conversation. And I think really the major part of this conversation will focus mostly on the here and now, because as we all know, with each year that passes it just gets that much more dynamic and, in a way, urgent. So I do want to – while I'm going to start with the Keating Government's policy on China, I do want to start by giving the audience just a quick taste of what's to come on the contemporary stuff with this question: you met Chinese President Xi Jinping last year, and you came away with this view – I'm not sure that you ever said it publicly, but certainly I know you expressed it: 'Never in all my years of going to China have I detected so seminal a shift in strategy and momentum.' Now, given the last 40 years of dynamic shift, that's a big statement.

**Paul Keating:** Contextually I think the 20<sup>th</sup> century economic and political order began when the United States overhauled Britain as the pre-eminent economic power in the middle of the 1880s, and continued through the 20<sup>th</sup> century. While China has not, in exchange rate terms, yet overhauled the United States, in purchasing parity times it's an economy virtually as large as the United States. So we're seeing, you could say, from the beginning of this century, a change in the economic underpinnings of the international order, in the same way as we saw the United States take the helm in the 20<sup>th</sup> century. So I think that's on. I think then, the financial crisis, in 2008-9, de-mystified for the Chinese the sort of mysticism the Americans had about being able to manage the international economic system. And when that became obvious, that the mystique had disappeared, that there was really chaos on Wall Street, and that the Chinese were invited into the G20 to help fund the recovery, I think the idea dropped in their mind 'Look, now is the time for us to press our case as a rising economic and strategic power.' And what China now wants to see is a new international economic and political order, which is not part of the order produced by the victors of World War II.

**O'Brien:** And that is the momentum that you're talking about. That is the seismic shift you're talking about.

**Keating:** That's the shift. So I think that shift is happening, and has happened. That's what I think.

**O'Brien:** So that's the taste of what's to come. Now, let's grapple with a little bit of history. You gave a speech just three months after you left office in 1996, which offered a summation of your foreign policy as Prime Minister, which you saw as the story of Australia's major reorientation towards Asia and the Pacific. You acknowledged Australia already had a long history of engagement with Asia, but you argued that this was the first time where all of Australia's interest – economic, political, security and cultural – converged. You believed no country was more important to Australian than Indonesia, and that the integration of China was central to the peace and growth of the region. Now, these were all your words in '96. The containment of China was counterproductive; engagement was the only way to go. So what were the key manifestations, if you like, for you in putting that broad foreign policy objective into effect?

**Keating:** Well, the Soviet Union was dissolved a week before I became Prime Minister. Gorbachev signed the document that brought the union down, and so you knew that the bi-polarity of the Cold War years had ended. The wall had come down earlier, in '89, and then the Soviet Union would dissolve. So I saw there was a chance for open regionalism of a kind that we'd never had in the world, really, since the Second World War. In Europe, probably; also in the Asia Pacific. And I thought that we could see the opportunity more clearly than the United States could see the opportunity. And as you may know – as you know, Kerry – I met President George Herbert Bush 10 days after I became Prime Minister and put to him proposals to set up what's now the APEC Leaders' Meeting, which has been meeting since 1992, to bring together the leadership – to create for the first time a piece of pan-Pacific political architecture.

**O'Brien:** At leadership level.

**Keating:** At leadership level. Well, here wasn't any really, except for the APEC meeting, which Bob Hawke had begun two years earlier, which was a ministerial meeting. But more particularly, there hadn't been – the US's fundamentally been an Atlantic power and the east coast establishment has an Atlantic focus. Policy in the Pacific was basically run by the Navy. So I was trying to get the Americans at presidential level to engage with Asia at a leadership level, but we had no structure. Before I turned up, the Australian Prime Minister only ever went to two meetings: The British Commonwealth Heads of Government meeting, which is the great world non-meeting, and of course the South Pacific Forum. That was it – that was all these people ever went to. And so I thought well ...

**O'Brien:** Well, a lot of bilateral and of course [inaudible] underpinning Australia's foreign policy, certainly in a security sense, was ANZUS, wasn't it?

**Keating:** ANZUS, yes. No, I'm talking about – ANZUS [inaudible]. I'm talking about in terms of engagement; we were still caught up in the British Commonwealth thing and we were big dogs in a small pool in the South Pacific. So I saw the chance of actually creating this piece of political architecture, but to do it, I had to bring in the Indonesians. Suharto had been, really, one of the leaders of the non-aligned movement during the Cold War. The Japanese of course always negotiated from under the table; they were never on top of the table. They were completely subordinate to the United States; they'd been a strategic client of the United States for 60 years. The Chinese, of course were effectively not conducting a foreign policy. They were modestly starting to feel their way. So I had to try and pull them together to sort of create this thing, and as it turned out, that happened. That happened.

**O'Brien:** One of the interesting aspects of this for me was the way you went about it, and it was very much Paul-Keating-driven. I mean, there might have been a lot of, not just input but even initiative from your foreign policy advisory team, but this was, in personality teams, this was very Keating-driven in terms of the personal relationship you sought to establish with Suharto, the pitch you put to Suharto about being a pivotal player in a whole new ballgame. You played – you built on a relationship of sorts that you have with Miyazawa of Japan – he'd become Prime Minister but he was Finance Minister while you were treasurer. But Li Peng was – George Herbert Bush was almost starting from scratch, and Li Peng too.

**Keating:** And Li Peng too. I had to get the Japanese Prime Minister Miyazawa, who was a great fellow; I had to get Suharto. Without Suharto, the Japanese would never have come in. And without the Japanese, the Americans wouldn't have come in. So the requirement then was to try and bring the Chinese in. And the great problem with that was the body that Bob had set up two years earlier – Bob Hawke – was a sort of mini-OECD organisation. You know, you show me your statistics and I'll show you mine, which had the economies of Taiwan and Hong Kong in it. And of course there was no way we were going to have a heads of government meeting where the Chinese would recognise the head of the government of Taiwan, or the head of the government of Hong Kong, as being of such status as to be present with the President of China. So I had to find a way around that to get them into it. As it turned out, we did, but the real point was, and this is your underlying point, and the question, Kerry, Australia does not have vital interests in Africa. It has vital interests in this region, and while Malcolm Fraser and Bob Hawke and others had spent years on great issues like Apartheid and other things, Australia's vital interests coalesced here, but we had no coalescence, no coalescent policy. That's not to say important things in the Asia Pacific had not been done – Gough Whitlam, of course, in his first visit to China; Bob Hawke himself and his encouragement of the Chinese relationship. But there was no – essentially Indonesia had been ignored; there was no framework and there wasn't a recognition that our interests, our vital interests, were here, and coalesced here. So by that stage, by 1992, I had already structurally reformed the Australia economy in the financial, product

and labour markets, and I was trying to sort of, shift the raft – to turn Australia towards its future. To find our security in Asia, not from Asia.

**O'Brien:** So looking – I mean, Bush initially basically left it to you to – he was essentially asking you to prove that you could bring these people together and actually get a serious effort rolling for a regional leaders' forum. And perhaps he didn't believe you could. But before long you were dealing with Bill Clinton anyway, and you had to start all over again with him. But since the key focus tonight is China, apart from the issue, the awkward issue of Taiwan and Hong Kong, I imagine that the Chinese would have still been extremely cautious about walking down this road.

**Keating:** Oh, they were. And I had a bit of help inside the place from Zhu Rongji who was the one great friendship I'd developed in China when he was Vice Premier and I'd been Treasurer here. He was Vice Premier when Li Peng was Premier. So he helped. And I think behind the scenes, Jiang Zemin, who was the President, helped as well, because he was the one who was going to be representing China in this body. So it took a bit of doing, getting the Chinese into this, and one of the compromises we made, it was supposed to be called the APEC Heads of Government meeting, and they wouldn't accept Hong Kong and Taiwan, so we changed it to the APEC Leaders' Meeting– you could be a leader of an economy but not a head government. So they turned up, but it was – at the first meeting, which President Clinton hosted at Blake Island off Seattle in 1992, there was, well, great reserve on the part of the Chinese President and the American President, yep.

**O'Brien:** But that developed, didn't it?

**Keating:** It did develop.

**O'Brien:** I think one manifestation of that, which you've talked about, is when the official photos were being taken – the sort of hand was going this way, but the faces were looking resolutely out the front. The eyes weren't meeting.

**Keating:** That's right.

**O'Brien:** But by Bogor in Indonesia?

**Keating:** A year later, I had Clinton playing the saxophone. And Jiang Zemin doing karaoke.

*[Laughter]*

**Keating:** It was a bit of a change in the tempo, and that's what these meetings were all about. Once you get to know somebody reasonably well, when a lot of this signals intelligence turns up about what's been said and what's going on, you have another basis for judging, for judging this material, you know, judging them. So I think it did make a big difference.

**O'Brien:** One of the, not so much sticking points, but one of the hurdles in this whole process too was the nature of the relationship between China and Japan, and I think Miyazawa gave you some insights into that. Didn't he pose a question – didn't he express his fears to you in at least one conversation?

**Keating:** He hosted me one night to a dinner, a traditional Japanese dinner in Tokyo, about four years earlier – four years before I became Prime Minister. And he said 'Tell us about the Chinese leadership – what they do; describe them to us. What do you think of them?' Because they never knew them, you see. And so I went through the group, and then he said 'Do you think they will attack us?' And I said 'No, Mr Miyazawa, I don't.' And he said quizzically, 'But why not?'

**O'Brien:** And that was sincere fear, sincerely expressed? Not just a bit of theatre?

**Keating:** Yes. That was the liberal democratic party, which Miyazawa was a sort of prince. The governing party of Japan in the post-war years saying 'This big state rising beside us is a malign state and we expect it, at some point, to attack us.' At some point. So they were the fears. So it was with that in my mind that this whole APEC leaders' thing came along, you see. Because we had to find some accommodation for Japan in this structure, and to interface them with the Chinese.

**O'Brien:** Now, it was also a serious hope of yours that this would develop into a strategic forum, not just an economic forum but a strategic forum, and informally in some ways, it may have done, but formally, definitely not.

**Keating:** No, formally, definitely not. Whenever the American President meets the Chinese President it is of its essence a strategic meeting – it cannot be anything else. But the agenda was nominally trade. The great value of the APEC meeting was they had these, what they called, bilateral meetings, on the days before the plenary session and the days after. So the US and China would meet and discuss all of their issues. At the meeting on the day before, between themselves. So what Bill Clinton said to me was – he had just defeated George Herbert Bush and one of the issues was the war in Iraq in 1991, where Clinton attacked Bush for the commitment to Iraq. So he said to me 'I can't be focusing on domestic issues and attacking Bush for international adventurism and then, five minutes later have you set up a big strategic body.' He said 'If you're prepared to make it look like a trade body, then I'm prepared to be in it.' And so we held the first meeting in Seattle, which was the home of Boeing and Microsoft. He wanted to give the impression it was sort of jobs across the Pacific, but in fact it was a strategic body where strategic discussions could be held bilaterally. So of course, you know, faced with that, getting the construct and as well as that, getting some trade sinews opened in the region, and at the same time, being able to hold

bilateral meetings around all sorts of issues, including strategic ones; well I took that as an acceptable proposal.

**O'Brien:** So let's come to today. I want to talk about the China that you know and see today, and you do have a particular set of insights available to you through your involvement as the Chair of the International Advisory Council of the China Development Bank, but I want to just as quickly as we can get your sense of the change that you have seen since you left office with those things – APEC and others – set up behind you, when you left office 20 years ago and today. If we started with the economy, because you said in the '96 speech, 'This is where the wealth of the region is being created, and at a rate and volume never before seen in the history of the world.' Well, if that was true of the region then, it's true of the region now, multi times over, but you could say that now of China alone today.

**Keating:** You could.

**O'Brien:** It's been a massive explosion, hasn't it?

**Keating:** It's a massive change. It is without precedent in human history, the economic shift in China. China had been through their first and second industrial revolutions in 25 years, the ones that took us two centuries to and they're now into the third industrial revolution. The digital revolution. So it's a gigantic achievement and China has gone from just an agrarian economy to now \$11 trillion of GDP. The US is \$17 trillion, China is \$11 trillion. China is growing at 6.5 per cent roughly, so you do the mathematics – 6.5 per cent on 11 is about \$700 billion of new wealth. The US is \$17 trillion growing at 2, which is \$340 billion new wealth. So China is doubling the amount of new wealth in the world, relative to the United States, right now.

**O'Brien:** So you've been Chair of that advisory council for the China Development Bank for nine years now?

**Keating:** Nine years.

**O'Brien:** So what exactly does the bank do? How big is it, and has that role given you special access or insight into the inner workings and inner thinking of China?

**Keating:** China Development Bank, the balance sheet is three times the World Bank, and its balance sheet is 2.2 trillion US dollars. Two point two thousand billion US dollars. And its default rate is less than 1 per cent, so it's a fantastic institution. It was built on the German post-war development bank model, and essentially provides development finance and funding for ports, roads, railways, airports, telecommunications, dams, etc. So all those fast trains, those cities you see – Shenzhen, all the big new cities of China, were core funded by China Development Bank.

**O'Brien:** So your primary role, and that of the council, is to provide your expert views of the rest of the world economy to China.

**Keating:** Fundamentally to set the context annually, seeing which way the Chinese economy is going to operate, how the environment is changing, and may change, and also to talk about the priorities within China Development Bank itself.

**O'Brien:** So the other side of the coin, of course, is your interface with the Chinese. What access do you get, what insights do you get, what briefings – what is the quality of the briefings you get from within China about their perspective, about their plans, about their goals?

**Keating:** I meet the executive group of China Development Bank, which is involved in virtually every major development in the country; I meet the head of the National Development Commission, which effectively runs the whole development process; the Governor of the Central Bank; the Vice Premier who runs the economy; mostly the Premier; and occasionally the President. So you get a look from the inside out.

**O'Brien:** So you've seen the thinking at the top as it's changed over those years, which must have been a fascinating process through the global financial crisis and China's response to that crisis – you touched on it for just a moment, but just try and give me some insights to how the Chinese handled – how they viewed the crisis, how they responded to it, that presumably, I think as you suggested, they saw it as an opportunity as much as what we, China, have to do to protect ourselves from this.

**Keating:** Well, they picked the calamity that was in prospect, and they were invited into the G20. The G20 was actually set up by George W Bush – the first meeting was set up at the end of the George W Bush presidency. And it was set up basically to bring the creditor countries – China – the big savings countries – China, Japan, Germany – together with the debtor countries in what was fundamentally a debtors' meeting. And the Chinese it was agreed at the G20 that all of these states would adopt stimulatory policies, while the Chinese adopted the most ambitious stimulatory policy. It not only saved China – that is, the stimulus, the capital spending and the credit, not only saved China; it has provided 50 per cent of world growth since 2009. Fifty per cent of world growth since 2009. And of course now in the after party, they've got hangover problems. The Chinese are now dealing with these hangover problems, but the effect was to give the country this big burst of growth and lift the world economy. So now they are working their way through it and China Development Bank is part of the workout. You know, there are these things like removing, dismantling oversupply, removing massive inventories, de-leveraging particular businesses, putting to death zombie companies, transferring other companies abroad; so the Chinese are now, quite mechanically working their way through the overhang of the crisis. Now of course here, the Rudd Government did the same thing with the stimulus – the

problem for the Rudd Government was that it never got the credit for it. Particularly with the coalition being as negative as they were about the waste of capital spending and the rest. The fact is, the stimulus removed the possibility of Australia having a recession. The Chinese did the same, but they did it writ large and on a much bigger scale. And the end result was it gave this big kick to Chinese growth. But more than that, it demonstrated to the Chinese that their days of belief in the US running the international financial system were coming to an end. So I think it was the financial crisis with Lehman Brothers and Wall Street in 2007-8 which finally tipped the Chinese into moving away from their policy of caution, understatement and reservation to a policy of clarity, assertion and ambition. China was the largest economic state in the world before the Industrial Revolution, and it will be the largest economic state in the world in the 21<sup>st</sup> century. So China is returning to where it was before the Industrial Revolution and they want to return in the context of an international strategic and political system, which is not what they call, an exclusive system. They regard the US system as an exclusive system; they see much more a UN-mandated system. But they also realise that we are now in a multi-polar world. So the days when China was a middle kingdom with all those people and all that wealth, while Europe was emerging from the Middle Ages, is over. We now have these big pockets of power in the United States, in North America, in Europe, in Africa, in South America. So essentially China is trying to establish, what they call, or what they would see as the democratisation of the international system. In other words, the non-management of it by one state.

**O'Brien:** Now, you – I think this was around the time of your advisory council – your annual advisory council meeting last year, where you had time with Xi Jinping and he touched on a number of these issues – the strategic issues – and China's plans, China's intent, if you like. He talked, I think, in particular about two things. One, he talked about the middle income trap, and we'll come to that shortly when we come back onto economics, but he also talked about the Thucydides trap, and this is really the original manifestation of this was when Athens was the rising power and Sparta was the dominant power. The implication obviously being that this is the United States and China. How clear was he – who doesn't want to avoid a trap like that – but what did you take from how he touched on that subject?

**Keating:** Well, he is saying how does the rising state meet the established state? Because in the last dozen times this has happened, there's been a big conflict. We had two world wars in settling the status of Germany. Two world wars. So we can't afford a world war with the huge military of the United States or China. The thing is, in the First World War, the leadership of the First World War didn't understand the power of the weapons that they had and which were unleashed in 1914. But leaders today do understand the power of the weapons, and therefore it is unthinkable that any leadership paradigm would think in terms of the full force of both conventional and nuclear weapons. So therefore it is not just a matter of a polite debate about how the rising state meets the established state. The fact is, you have this



huge colossus rising in the east, the United States, under the Nixon-Mao deal of 1972 had established itself in a position of primacy both with Japan and with China, with acceptance by China. Fundamentally the underpinnings of the Nixon-Mao deal fell away the moment the Soviet Union was dissolved, because Mao did the deal with Nixon because of Soviet infantry on Chinese borders at the time, and the threat from the Soviet Union. An ideological state looking for world dominance. So therefore Mao signed up with Nixon to both recognise the United States as having strategic primacy in Asia, with China accepting that, and also seeing China being open, being made – China being part of the US trading system with investment and technology.

**O'Brien:** And I think what you've said is that with the collapse of the Soviet Union, China went from being a card that was played by others at the big strategic table to a major player itself in the game.

**Keating:** Well, what happened was the underpinnings of the deal fell away when the Soviet Union fell, but China was too weak to push the United States away. All through the 1990s it accepted US primacy and has accepted it, I would say until, 2008-9. The switch comes about 2008-9. Basically the United States is still fundamentally pursuing a policy for the maintenance of primacy against the obvious rise of China, therefore resisting the idea of sharing strategic power in Asia. Which I believe the United States should do with the Chinese. So we're at this sort of turning point. China is a continental power and the United States is fundamentally a naval power. China, has the Pacific to the east, has Mongolia to the north, the Himalayas to the south, and has the Stan countries to the east. It's landlocked. Its only way out is through the old Silk Road. It is fundamentally a continental basin, and doesn't seek to become a predominant strategic world power. So it has asymmetric advantages over the United States. The United States wants to be the primary world strategic power, with control of North America, the Atlantic, the Middle East and Asia, where the Chinese are in the advantageous position of seeking only to be interested in the corner of one ocean, the Pacific Ocean. And they sit there in their continent. And that's why they're worried about their coast, and they're worried about their environs, because this is how they see their world. So it's very different – they're coming at the world in a very different way to the United States.

**O'Brien:** And you're convinced that they have no ambitions beyond what you've described – that they have no ambitions for at least an equal, if not the dominant, geo-political status in a future world?

**Keating:** No. I think China will again be the largest state .If strategic power comes from economic power, China will again be the largest state in the world. The industrial revolution broke the nexus between population and GDP. Before 1800, the work all of us did in the world was of the same value. We fed ourselves, clothed ourselves and housed ourselves, so productivity, by muscle power, was equal across the globe. So therefore the countries with the greatest population had the greatest GDP. China had the greatest GDP

before 1800. All of a sudden, a little country like Britain starts using congealed energy, fossil fuels, in steam, and the Industrial Revolution begins. And all of a sudden a relatively small state like Britain has a bigger GDP than China. So the link between population and GDP was broken by the Industrial Revolution. Now, with globalisation, the ubiquity of the technology and the capital is re-joining the link between population and GDP. So again, the countries with the biggest population will again have the biggest GDP. The chance is that China will have 1-2 times the aggregate GDP of the United States. So if we live in a world where one state has 1 or 2 times the aggregate GDP of the other great international power, can the world be as it was? Well, the answer is no. So this is why the Chinese want a new international and political order, which they suggest is about democratising power. And that means, you know, great states in Africa, great states in South America, the brick countries – Brazil, Russia, India – which they belong to. They see this kind of much wider structure of the world being their bailiwick, than simply being a strategic stakeholder in the way the former US Assistant Secretary of State Bob Zoellick said ‘We welcome China as a stakeholder.’ That means we welcome China as a stakeholder in our system. The Chinese said ‘Really?’

**O’Brien:** There’s an irony when you talk about their concern to see a more democratic process globally, when you look at the process which is fundamentally still authoritarian inside their own country.

**Keating:** Don’t get too hung up on the words democrat or democracy – I mean a more representative structure, a more representative structure of world power. I think that’s what they see. But unlike the Soviet Union, China is not an ideological state. It is not challenging the United States globally, and will not challenge the United States globally. Certainly not in any ideological sense.

**O’Brien:** Did Xi Jinping make that clear in the conversation you had with him in his address?

**Keating:** He said Bonaparte – I remember him saying ‘Bonaparte said China is a lion asleep.’ He said ‘Yes, the lion is awake, but it’s a civilised lion, a friendly lion.’

**O’Brien:** Did he say how the friendly lion would react if it got a poke?

*[Laughter]*

**Keating:** So the Chinese are all about pushing American naval power away from their coast. But the Americans still operate surveillance across the Chinese coast. If the Chinese blue water navy sailed down the coast of San Diego, I mean, the Americans would be horrified. And you saw what happened with Jack Kennedy and Cuba – when the Soviet Union tried to put missiles on Cuba, Kennedy and the Americans made clear that the Caribbean

was their area of very exclusive domain,. And this is underpinning, in a messy kind of way, what's happening in the South China Sea.

**O'Brien:** It is messy, isn't it?

**Keating:** Yes, it's messy.

**O'Brien:** And there's a certain amount of muscling up.

**Keating:** It's basically China testing the strategic limits, and doing it in a very cheap way. It's got no territorial – there's no territory involved here, except some rocks in the South China Sea, which they have built some sand islands on. So at a very cheap price, they're putting strategic pressure on the United States.

**O'Brien:** And are you sympathetic to the United States' position in this?

**Keating:** Let's go back a little in history. What brought all this on was the Japanese foolishly, the Japanese Government acquired two of these islands from a private owner. And once the Japanese made the statement of saying 'These islands are ours, and ours nationally, they brought the whole thing to a head. Chinese nationalism, I think, in their broader claims, decided to make the islands an issue. But the islands are really the manifestation of the problem, not the problem. The problem is the fact that power in the Pacific is not resolved. The US – President Obama's pivot – that policy was basically about maintaining US strategic primacy, notwithstanding the rise of China. Now, China's saying 'Look, this is not on. This is not good.' Now the US is not going to sit down at cabinet level or at congressional level and say 'Right, we recognise that China is a great state. It now has a GDP approaching our own, and we are going to re-cut the power.' They're never going to do that. There is never likely to be a formal agreement – a formal re-cutting of the power. So we're going to have these informal understandings about where the limits of power may lie, and one of the issues in that understanding, of course, is the South China Sea.

**O'Brien:** So when you say there are going to be these informal understandings, do you think that's just the way it's going to be, or do you think that's an understanding within the American power structures?

**Keating:** I do not think the US is capable of discerning or divining a new power arrangement towards China. I don't think what Henry Kissinger and Nixon did is capable of being done today.

**O'Brien:** So where does that take us?

**Keating:** The US is unled. Certainly in Asia it is unled. That is, not having a relevant strategic template.

**O'Brien:** So you don't mark Obama very highly on that front?

**Keating:** Well, I mark Obama well for a return to liberal internationalism in international policy. And I mark Obama well for keeping the United States out of conflict in many places where it would otherwise be urged to undertake military activities. But essentially, the United States did not see China coming, and only saw it arrive at the G20 in 2009. It does not have the statecraft, does not have the psychological framework or intellectual power to divine in its current system, a new relationship with China.

**O'Brien:** Is it as bald as this: that having been the dominant power globally for so long, particularly post the collapse of the Soviet Union, but for so long, really, that they are not prepared to envisage a world where they have to share that power?

**Keating:** The United States has never – in its economic and strategic history, ever met a power with an economy and a society as large its own. It's an affront to everything that is represented by American exceptionalism. The American mission is the propagation of US social and political values. The US sees itself as having a mission to propagate Jeffersonian values, and it believes it is the exceptional state in the world.

**O'Brien:** There have been times in history where the rest of the world, or much of the rest of the world, including Australia, has been very thankful for that.

**Keating:** That's true. But events and history change. Before that, it was Britain, in the 17<sup>th</sup> and 18<sup>th</sup> century, and in the 19<sup>th</sup> century. Then the switch from Britain turned to the United States in the last quarter of the 19<sup>th</sup> century, and we had an American century through the 20<sup>th</sup> century. We've got another switch on our hands now – another turn with this other great state. The Chinese know who they are and what they are – there's nothing skittish about China. They've got a society that's been operating for a couple of thousand years, and they think they've had a raw deal in the Industrial Revolution in that they missed it. They had 200 years of occupancy and adventurism by European powers, including Japan, so they're now saying 'Okay, that's over. We're now back in the game.' I think the Chinese are smart enough to know there can never be one power in the world ever again. They want a multi-polar structure, but they're not going to be, in any way, a subordinate power to the United States.

**O'Brien:** Can you see a world in the not-too-distant future where China and Japan actually have a healthy relationship, where Japan has been able to cast aside its fears of China, where China has been able to cast aside its memories of the Japanese, particularly World War II?

**Keating:** That's a possibility, and I think that the demographics of Japan, the ageing of Japan, is going to produce a political outcome at some point where

an accommodation with China will become a more obvious pursuit of the Japanese.

**O'Brien:** Do you have a sense of where Xi Jinping is on this?

**Keating:** Well he had his Prime Minister meet the prime ministers of Japan, of Taiwan, and South Korea last year, so I think the Chinese want to, if you like, tidy up the east. Their real future is in the west. They want to rebuild the old Silk Road, railways and highway up through the Stan countries, up to Istanbul and to the Baltic Coast of Poland, so what I think we're going to see is a reasonably obvious economic – I'd use this in inverted commas – an 'economic colonisation' of the 50-odd states between the western border of China and Eastern Europe.

**O'Brien:** So when you say the colonisation, you mean ...?

**Keating:** Well, the delivery of economic goods. The delivery of economic goods. The integration of these countries with the economy of China.

**O'Brien:** And of course you're seeing a new relationship developing now of course between the Russians and China?

**Keating:** That is, a sort of natural corollary of this development. The United States has always been – not only did the pilgrims find this wonderful, arable country, the United States has been protected by two oceans, the Atlantic and the Pacific with two friendly states to the north and the south with Canada and Mexico. But in many ways, compared to where China is, the oceans are now a corset for the United States. Whereas China's has this opportunity through Central Asia and Eurasia, which I think they will rather ruthlessly exploit.

**O'Brien:** So when you're talking about China policy under Obama, of course, Hillary Clinton was very much at the heart of that for his first term. And we're almost certainly – I'll take the almost out, because I don't want to believe the opposite.

*[Laughter]*

**O'Brien:** A Clinton presidency. More of the same

**Keating:** It would be the denial of reality to keep it all the same. And I think Hillary Clinton's too smart for that, frankly. This is my view about the United States – I said this to Clinton in 1997. I said 'The United States should consolidate the Atlanta.' I said 'You let China into the WTO, China will be a state as large as you.' Bill at the time didn't believe that, by the way. I said 'The US should consolidate the Atlantic.' It has \$17 trillion in GDP in North America; . They've got the Atlantic itself, they have NATO, they have \$20 trillion of GDP in Western Europe. The great challenge of the United States in

Europe is to integrate Russia into Europe. And to deal with Turkey. But you could consolidate the Atlantic. So in the Atlantic, the United States should be the framer and the guarantor of security of this region, whereas in Asia, if it persists in trying to and be the framer and the guarantor, it'll run up against China. And China's legitimate interests.' So I told Clinton at the time, I believe that the United States should be the balancer and the conciliator in Asia, rather than the framer and guarantor. Now, if Hillary Clinton believes that the United States still has the maritime capacity and the strategic capacity to be the framer and the guarantor in Asia, despite the legitimate ambitions and economic scale of China, then I think that would be a great mistake, and a mistake I don't think she is likely to make.

**O'Brien:** You've talked recently about a fundamental difference of culture, really, in the way the Americans negotiate compared to how the Chinese negotiate. I think with the Americans you said – not just the Americans, but the west broadly; the west anticipates resolution following negotiation; for the Chinese it's one long negotiation.

**Keating:** In the western mind, there is always this idea that you have an objective; you have a beginning, a middle and an end and you go through reasonable processes of consultation, discussion, and you arrive at a set of conclusions. This is not how the Chinese think at all. China is moving out of the cocoon of its misfortune through the 19<sup>th</sup> and 20<sup>th</sup> centuries into the opportunity of the 21<sup>st</sup> century. Not only is it difficult for them to divine a policy for themselves, but there is something in the Chinese psychology which is not about defining it anyway. So the United States is always looking for conclusions from the Chinese, which the Chinese will never provide them.

**O'Brien:** So I think one senior Chinese official – I'm not sure whether this was your most recent visit over there or the one before. She talked about the fact that China and America were each kind of talking past the other.

**Keating:** Yes. Each says they believe in the current international system, but the Chinese regard the current international system as essentially a US-based system, which is exclusive, in which China is not part of the security and strategic arrangements. Whereas when the Chinese talk about the international system, they're talking about the UN system – remember, they're sitting in the UN and they have a veto power. So they're one of the five permanent members of the Security Council. So they see this sort of a system, notwithstanding its deficiencies, as being more representative than the exclusive system the US is running. So that's why they say, they're talking past each other. They say 'Look, we believe in globalisation, believe in international trade, we believe in the fungibility of money worldwide. We believe in the international economy, we believe in the international system, but we're sort of talking past each other.' So essentially – and you can see also Chinese interests in Africa are in these great states in Africa – South Africa, Nigeria, these sorts of countries, which are going to come up in the world in the 21<sup>st</sup> century, and are not part of the governing system.. So the

Chinese will press on with this demand of theirs or this policy of theirs to, they say, democratise the international system –make it more representative. And the Americans will try to hang onto the power for as long as possible. That's what going to happen.

**O'Brien:** Now let's come to Australia in all of this. We've talked about what you sought to do 20 years ago; you've obviously been a very keen and interested observer of various governments since, but what do you think Australia should be doing now, compared to what it is doing in the context of all that we've been talking about? Let's talk about the geo-political first – the United States, China. We kind of easily talk about special relationships – we've certainly got a special treaty with America, which gives us a certain kind of entrée, gives us a certain kind of voice. China, on the other hand, is this massive trading partner of ours with whom, on whom, we have enormous dependence. But it's pretty clear observation that when it really comes to the crunch, we go that way; we don't sort of go a little bit each way. If we had to take a position between America and China, we would almost certainly, in every big instance, go with America, wouldn't we?

**Keating:** Well, the fact is Australia needs a foreign policy, and it needs one urgently. Australia does not have a foreign policy – that's the biggest problem. A lot of these humanitarian things we do, whether we're recovering people from the Ukraine after that disaster, these are worthy things for the Australian nation, but they are not a foreign policy. We both need and deserve a nuanced foreign policy, which does take account of these big seismic shifts in the world. And we can't ever be caught in some containment policy towards China, or seeming containment policy of China, to assist the Americans to try and preserve strategic hegemony in Asia, in the Pacific. Strategic hegemony by the United States in the Pacific is incapable of preservation, and therefore, we should be urging American friends – and they are our friends – to recognise that the US has got to move from a framing and guaranteeing role to a balancing and conciliating one. And I think it is very important that the Chinese recognise the importance of the United States and the importance of continued US engagement in the region. So this sort of policy would matter a great deal to us. The other thing is that I think the days when we had influence as China was rising – for instance, look at us as a gift of Australian foreign policy putting together the APEC Leaders' Meeting in my case, or Kevin Rudd's involvement with the East Asia Summit. Those days are, I think, now very limited. I don't think the Chinese or the Americans need us to negotiate with them or between them, and therefore I think we're becoming a much more marginal power than we were even 20 years ago. Much more a marginal power

**O'Brien:** Our influence is waning, is that what you're saying?

**Keating:** Our aptitude and foreign policy smarts may not be waning, but our influence is waning. Therefore I think we should be more interested in the immediate world around us. This is why I've always believed Indonesia,

there's no country more important than Indonesia to us, because where Indonesia goes, strategically so do we. And ASEAN, which was once a body managed by great minds like Lee Kuan Yew, President Suharto ...

**O'Brien:** Can you get the name Mahathir out?

**Keating:** Well, Mahathir at least knew what he wanted. I've never thought much of his administration, but at least he knew – he had a vision of what he wanted. I think ASEAN has drifted, and I think our membership of ASEAN would make a great difference to ASEAN, and gives us a home. But more particularly, a home that the Chinese and the Japanese regard as very important. They regard Southeast Asia as a particularly important place between them and that other great state; a potential rival of theirs, India. So the fulcrum area is Southeast Asia. You've got India on the one side, China on the other, both in their particular oceans. And the United States, of course, has relationships and friendships with many of the countries of Southeast Asia. So therefore it is in our interest to see ASEAN succeed, and I believe we should become a member of it. In other words, recognise where we are influential, where we can add value, and at the same time, where we sort of insulate our own security and opportunities. Preserve our opportunities.

**O'Brien:** If we're going to be serious about that, and let's say we started walking down that line, does there come a day when ANZUS, in the way it's been understood and practiced in the past, becomes anachronistic? Outlives its value? I mean, I know that strategically Australia regards it as terribly important, the access it gets to intelligence, because of the ANZUS treaty, but in the world that you're describing, can we continue not just to exist in this region, but be seen as a genuine player and a genuine participant in this region, but our dominant and pre-dominant relationship is with the United States.

**Keating:** Look. The alliance with the United States has underpinned Australia's security in all the post-war years. This primarily relies upon the United States being the pre-eminent superpower, and the strategic power in the Asia Pacific – the sole strategic power. That has changed. What I think Australia should be doing is using diplomacy, that is, the elasticity of diplomacy and foreign policy as our first power – as our first power – and therefore try and construct a progressive and ambitious policy towards the countries of the region most important to us. The big ones like Indonesia, Southeast Asia, Indochina, China itself, Japan, where we take these countries' interests to heart, at the same time recognising the legitimate role and power of the United States in the area. Now, I think all this can be achieved consistent with the ANZUS alliance. I don't think it needs to be some exclusive arrangement outside the ANZUS alliance. But the days when we sort of underrate diplomacy in foreign policy and essentially try and to find our security from Asia rather than in Asia, which was basically the Howard policy, fundamentally, would be a mistake on our part.



**O'Brien:** We've seen the Trump phenomenon, and even though Trump will almost certainly go down, the disaffected people who have given him his rise will still be there, and a part of the kind of phobia and the fear that drives them is this word China. In Australia, we've seen the rise of Hanson again – the re-emergence of Hanson. We saw, for instance, the Treasurer Scott Morrison decide to knock back the Ausgrid – the attempt, or the offer by Chinese interests to take a 50 per cent interest in Ausgrid. He said on grounds of national interest, and in fact it's been reported that the board also received advice from intelligence agencies recommending against it on national security grounds. But this is in the – against the background of Hansonism, and that kind of worry about xenophobia. So Scott Morrison might be making a perfectly legitimate decision there, but for some already it's seen as more responding to Hanson, who's going to be a vote they may need on crucial bills in the senate. So you've got these elements mitigating against cool, sensible, rational decision-making on foreign policy in this country, and with sort of Trumpism in America. It's true, isn't it?

**Keating:** Well, let's go to the Trumpism first. I mean, Trump may win. Trump may win.

**O'Brien:** I refuse to believe that, Paul. I don't – I mean ...

*[Laughter]*

**Keating:** But whether Trump wins or not, whether the US continues to bear the burden, as Jack Kennedy said, and try and maintain power across three oceans – the Atlantic, the Mediterranean and the Pacific – with a massive call on American savings and American economic wealth, or whether not an isolationism in America – I don't think we're going to see a '30s isolation, but let's call it some withdrawal of American power. One place Australia does not want to be is having put all of the chips on the United States, to find the United States withdrawing from the region. I don't think the United States is going to withdraw from the region; I think its role in the region has to change, but a wise country, and I'd like to think Australia is a wise country, will at least hedge its bet on the possibility of US strategic withdrawal of some measure in this part of the world, which augurs again for the argument of running a nuanced, balanced cooperative foreign policy in lieu. So that's one of the issues in Trumpism. The other about xenophobia – the problem with a double dissolution is you halve the quotas, so all the rubbish in the world comes into the senate. So when 12 senators, you divide 12 into 100, 12 8s are 96, eight-and-a-bit per cent, and then you get a quota. So of course, all these xenophobes turn up; all sorts of people turn up.

**O'Brien:** But Hanson's vote is a reflection of something, isn't it? It is a reflection of, you might say, ignorance, but it's fear. Fear and ignorance go together, isn't it, and the fear ...

**Keating:** It's reactionary. It's reactionary.

**O'Brien:** It was a bigger vote than I would think we should be comfortable with.

**Keating:** It is. It's reactionary. Sure. But it can't, it doesn't control the executive government, and shouldn't.

**O'Brien:** No, but it's not a good climate for – I mean, we're looking at these controversial decisions being taken in regards to foreign investment, and there's a difference between a foreign company wanting to invest in Australia and a company that's controlled, run, whatever, by a state. They're two different things. Nonetheless, this is not a great climate for rational decisions to be taken and accepted as rational.

**Keating:** Well, I'd be disappointed if the Treasurer made a decision with reference to the climate rather than the issues. I think the Treasurer should be capable of making the decision with reference to the issues rather than the climate.

**O'Brien:** And you think the decisions thus far on these issues, the Kidman one is another one, have been taken on the issues rather than the climate?

**Keating:** It's a bit hard to know. For my part, there is controversy around China State Grid. With a different hat on, I actually helped China State Grid purchase a part of the Victorian electricity holdings of Singapore power, so, in a sense, where these assets were not strategic, I have no problems about China State Grid being a state-owned enterprise of China. But I would take a position that I don't think any state-owned company of any country ought to hold, or be able to own and control, key strategic telecommunications assets in Australia. You know, I don't – the Chinese would never allow Telstra to have key communication assets in Beijing or Shanghai, and nor should they, any more than we should let a Chinese state-owned country hold key telecommunication assets here.

**O'Brien:** I don't want to get bogged down – this is my last question on it – but strategic assets don't begin and end with telecommunications though, do they?

**Keating:** No, they don't, and therefore that means the Treasurer acts up on the advice of the Foreign Investment Review Board where these questions are considered. But where you've got a bunch of assets which are not strategic, or necessarily that strategic, then I don't see any problem about China State Grid, or any other Chinese state-owned enterprise, owning them.

**O'Brien:** Now, we're getting close to time, but I do want to come back to economics a little bit, and I want to come to that other point that Xi Jinping made about the traps he wanted to avoid, and one of them was the middle class trap.

**Keating:** The middle-income trap.

**O'Brien:** Sorry, the middle-income trap. Now, what is the trap, and how is he going to avoid it?

**Keating:** Put it this way. The story of modern China is fundamentally a story of urbanisation. Half the country moving to the cities. The cities are full of people and the price of people normally goes up. So if the Chinese want a consumer and service society of the kind we have in this city of Sydney, then they have to have incomes rising. And it is the policy of the Chinese State Council to see strong income growth to underpin a metropolitan, cosmopolitan service economy. You can't have incomes rising and at the same time make cheap manufactured goods competitively. So at the moment, Chinese employment and a lot of economic activity, is in the production of goods, which it sells to the world, which are made at low costs by people paid on relatively low wages. So if China is to see itself moving to a middle-income status in the cities, and therefore as a society, the two are inconsistent. You cannot manage and have in the one country very low paid people doing manufacturing and much higher paid people – I mean, Xi Jinping was saying to me that he wants to see Chinese average incomes per capita at \$12,000 US by 2020. Twelve thousand US dollars. And he said by 2020, we should have GDP of \$16-18 trillion. He actually nominated the numbers. Sixteen to 18 trillion. He's saying by 2020, we'll have an economy the same size as the United States, and we'll have a moderately high-income society. To get to there out of the current drivers of growth, which are state investment in roads, airports, railways, steelworks, all massively overinvested, and low paid manufacturing jobs, to get away from these traditional drivers, to get up to the higher orders of services and manufacturing, one has to escape this trap – the middle-income trap. In other words, you've got to make a choice here. You've got to either head to the higher orders of incomes and services or you stay locked in to the East Asian drivers of capital investment and low paid jobs in manufacturing. And that's their problem. If they get out of the manufacturing too quickly, they end up with high unemployment and social unrest. But if they don't continue to move up the value chain, they end up with just a low-grade society, which will never challenge the United States in its bulk. I believe the Chinese will escape the middle-income trap, that they will make these changes – for instance, what China Development Bank is now doing in terms of unwinding over capacity, funding the reduction in inventories, in dealing with the over leveraging that came out of 2008-9, both through the banking system, these sort of changes are important changes on the pathway to the higher order economy. So I think they'll get there – it may be a bit messy, maybe a bit slower, but I think they'll get there.

**O'Brien:** And also they, I mean, in the kind of the pragmatic approach they're taking, they're going to cut back further in terms of steel consumption, they're going to cut back very substantially on coal consumption, aren't they?

**Keating:** They're already going to take another 100 million tonnes out of steel in the next year or two; they're going to take another, I think, 500 million tonnes out of coal. They're cleaning up – green technology is a big growth thing for them; they're cleaning up the environment. It's becoming – China's become more and more a tertiary economy, and its research and development is not going to be research and development based on western technology. They're going to be able to develop their own. And also just their commerce platforms, like Alibaba. Alibaba had 45 per cent growth in revenue in the last six months. It's got 78 per cent market share. Alibaba, these private internet businesses are going to massacre the state-owned enterprises. So we're going to see this big shift from state-owned enterprises to private enterprises in China by way of the connectivity of the internet and open sourcing.

**O'Brien:** Somewhere in all of that, of course, managing their own domestic politics, political situation, and dealing with whatever upward pressures there are for a more democratic society. But the kinds of shifts you're talking about, the economic shifts in China, have got huge ramifications for Australia, given how much we've relied on our commodities for our wealth.

**Keating:** Well, look at this university – the Chinese students here. So this is why, you know, the Chinese have taken half a billion people out of poverty. It's a massive achievement. They now have rising incomes, they have modern cities, they have modern infrastructure, modern highways, they have modern railways, they have modern telecommunications. And they're going to have higher incomes with people bidding for services and high value-added goods. So this is going to be a massive force of an economy to be dealt with. And the benefits for Australia are going to be profound.

**O'Brien:** How well prepared are we to achieve those benefits, to guarantee those benefits?

**Keating:** I think we're reasonably well prepared. We have – this is a very flexible economy via the exchange rate, wages; we're competitive, we're open, our service sector is of high technical value, our supply chains, our management groups are good. I think there's a real – we have a very great opportunity to maximise the China opportunity. But we'll need to have our eyes open for it, and go and do it.

**O'Brien:** Paul Keating, it would be nice to end on an optimistic note. Thank you very much for sharing your thoughts with us on China. Thank you.

**Keating:** Thank you.

*[Applause]*

**Bob Carr:** Well, ladies and gentlemen. Insightful, refreshing, brilliant: the mind of Paul Keating being probed and prodded by a veteran interviewer, a great interlocutor in Kerry O'Brien. I know I speak for everyone here when I record

how delighted we are for this opportunity – this was an unforgettable insight for all of us into the thinking of, not a former Australian Prime Minister but an Australian strategic thinker. Someone thinking to this day, years after having served his country so well as Prime Minister and Treasurer, about how Australia makes its way in the world. And for giving us those insights, to the two of you, much thanks.

The Australia-China Relations Institute takes an unabashedly positive view, like the tone just captured in the final answer by the former Prime Minister, of what this relationship means to us. Founded with the support of Xiangmo Huang, who's with us tonight, backed now by 20 Australia corporates, recruiting new members from both China and Australia, sustained by this splendid university, we take a positive view of where this relationship can go for Australia, and for China.

It would be a different way of making a China policy – we could take the view that's expressed in columns every week in the Australia media that effectively says Australia should forget about having its own China policy; just see it through the lens of Washington. That will simplify the choices for us. We wouldn't have joined the Asia Infrastructure Investment Bank. We had a choice – we might have taken the choice not to have joined. We would be running patrols right now in the South China Sea that penetrated a 12 nautical mile radius around Chinese structures. We'd be the only American friend, partner or ally to do it – but it's a choice. We could do it, and have our relationship with China take a serious hit. We could have dumped a competitive tender process and just chosen to buy our subs from Japan, which would have sent a message to the world that we were somehow lining up for a trilateral policy designed to contain China.

We could have done all these things. But we do have the option of doing what other Western-aligned nations do, and that is craft a China policy that takes account of our interests – Australian interests. A pragmatic China policy, which is what every American friend, partner and ally, apart from Japan, which has a delicate relationship with China, pointed to in this conversation, weighing on it. But the choice is there. We can opt to have a policy that takes account of Australia's interests, or we can choose that somehow in our inadequacies, we can only see China through a Washington lens. And some people would have us do that. I think a lot of Australians would think in the East China Sea we should be neutral. In the South China Sea, we should move with like-minded opinion, not make a flamboyant gesture of running patrols that won't resolve anything. And that we were right to join the Asia Infrastructure Investment Bank, not take the advice of the US President – advice I think that he now regrets giving, that we should stay out of it.

In other words, we're capable of having what we say in ACRI is a positive and optimistic view of the Australia-China relationship. And in what seemed a hundred ways, it was pointed at and confirmed and picked over and analysed in the conversation we've just been privileged to here – the notion of Australia

helping to construct a conversation between a US President and a Chinese President in a forum that hadn't previously existed. Or the idea that China is doing nothing more than returning – returning to a status it had in the world in the early part of the 19<sup>th</sup> century. But, and Paul underlined this on a few occasions, doing this in the expectation that it will be part of a multi-polar world. It's not seeking hegemony; it's seeking to have influence in its environs. It's not seeking to have its system promoted halfway around the world, promoted in every continent of the world. The elasticity of diplomacy was one of those beautiful, keen locutions, and it's an invitation for all of us to think about what diplomacy can do – what an active foreign policy can do in resolving differences and in creating opportunities, and keeping options alive for Australia, not closing them off in a burst of flag-waving and table-thumping.

China, the former Prime Minister said, is looking to exert legitimate power, and America would be well advised to work out ways of sharing that – that is, power in the Asia Pacific – with a China that's going to have, as we keep saying, a middle class with 850 million more people in it, only 14 years from now. And there lies Australia's great opportunity even, as Paul contemplated, with the winding down of steel and coal, the end of that sort of relationship between Australia and China. So many opportunities in a China that's driven by consumption – the growth of the consumption sector – and driven by the colossal growth in services. I can imagine Paul saying, if given the opportunity, there'd be something wrong with Australia if we can't make our fortune out of that new China – that China surging into predominant middle class status; 70 per cent of its population with middle class standing and spending power.

For all of us attached to this great university, this has been a wonderful evening – one that I, as I said, I don't think any of us are going to forget. Kerry, you made it possible; Paul, thank you for being so very, very generous with your time, and thanks for sharing a vision, and vision I think summed up by this notion: that Australia can be brave and big enough and imaginative enough to devise and nurture and craft its own policy with the people of this re-emergent China. Thanks for being here, thanks for sharing it with us, and thanks to our two wonderful guests.

*[Applause]*