

China's March on the 21st Century

Kurt M. Campbell, Editor • Willow Darsie, Editor



THE ASPEN INSTITUTE



A REPORT OF THE ASPEN STRATEGY GROUP
JOSEPH S. NYE, JR. AND BRENT SCOWCROFT, CO-CHAIRMEN

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Co-Chairmen

Joseph S. Nye, Jr.

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PREFACE AND ACKNOWLEDGEMENTS

From August 4th through August 9th, 2006, the Aspen Strategy Group met in Aspen, Colorado to examine questions surrounding China's rise into the 21st century. Representing diverse perspectives from multidisciplinary fields, Aspen Strategy Group members, invited guests, and China experts collaborated on furthering understanding of the complexities of a rising China and the implications for the United States and the international community. This publication presents the 11 papers that helped guide and illuminate our discussions over the week. It also includes the workshop scene setter and a set of concluding observations.

Our meeting was a result of the collaborative efforts of a number of organizations and individuals to which the Aspen Strategy Group is deeply grateful. We thank the MacArthur Foundation, McKinsey & Company, Citigroup, the Harman Family Foundation, Synergics Energy Development, General Dynamics, and the Friends of the Aspen Strategy Group for their generous and essential support. In particular, we extend our profound appreciation to Robert and MeiLi Hefner for their critical role in bringing for the very first time distinguished Chinese guests to our dialogue, which we hope has contributed toward building the mutual friendship and understanding that the Hefners have long envisioned. In addition, Kenneth Lieberthal contributed invaluable expertise and guidance as special advisor to our workshop. We thank our Brent Scowcroft Award Fellows for their important contribution to this initiative, and we wish them well in their future endeavors in the field of foreign and national security policy.

Finally, our efforts would not have come together without the leadership, vision, and support of our Co-Chairmen Joseph Nye and Brent Scowcroft. Thank you both for making possible an exceptional summer session in Aspen.

Kurt M. Campbell
Director

Willow Darsie
Deputy Director

Aspen Strategy Group
Washington, D.C.
January 2007

DISCUSSANTS AND GUEST EXPERTS

Titles and affiliations are current to the August 2006 workshop.

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Chinese Academy of Social Sciences

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Ruan Zongze, Vice President, China Institute of International Studies

Wang Jisi, Dean, School of International Studies, Peking University

Zha Jianying, China Director, India China Institute, The New School

BRENT SCOWCROFT AWARD FELLOWS

Shannon Hiller, University of Georgia

Benjamin Newton, University of Pennsylvania

Hao Yan, Stanford University

Howard Yuan, Peking University, University of Notre Dame Law School

WORKSHOP AGENDA

FRIDAY, AUGUST 4

Joint Aspen Strategy Group Dinner with the Rickard C. Blum Roundtable on Global Poverty

Hosted by Dianne Feinstein, Senator, United States Senate; and Richard Blum, Chairman and President, Blum Capital Partners, LP

SATURDAY, AUGUST 5

DAY I: THE CHINESE ECONOMY: MAKING STRIDES, GOING GLOBAL

Opening Breakfast Presentation:

The History of U.S.-China Relations

- Ernest May, Professor of History, John F. Kennedy School of Government, Harvard University; former Senior Advisor to the 9/11 Commission and Dean of Harvard College

Introduction:

Opening Remarks

- Joseph Nye, Distinguished Service Professor, John F. Kennedy School of Government, Harvard University; former Assistant Secretary of Defense for International Security Affairs and Chairman, National Intelligence Council
- Brent Scowcroft, President, The Scowcroft Group; former Assistant to the President for National Security Affairs

Discussion of Scene Setter and Comments on the Overall Agenda

- Kurt Campbell, Senior Vice President, Henry Kissinger Chair, Director, International Security, Center for Strategic and International Studies; Director, Aspen Strategy Group; former Deputy Assistant Secretary of Defense for Asia and the Pacific and Director, National Security Council

Video Presentation: China's March on the 21st Century

A Production of the Aspen Strategy Group

Session I:

A Net Assessment of China's Domestic Economy, Commercial Achievements and the Challenges Ahead

Presenters

- Dominic Barton, Chairman, Asia Region, McKinsey & Company; former Managing Partner of McKinsey & Company Seoul Office
- Jonathan Woetzel, Director, Greater China Office, McKinsey & Company

Session II:

China's International Economic Strategy: The Rising Tide of China's Trade

Presenters

- Lael Brainard, Vice President and Director, Global Economy and Development, The Brookings Institution; former Deputy Assistant to the President for International Economics, Deputy National Economic Advisor, and Chair of the Deputies' Committee on International Economics

Strategic Interventions

Chinese Urbanization: From Rural Areas to Global Megacities

Huang Ping, Director General, Bureau of International Cooperation and Exchanges, Professor of Sociology and Deputy Director, Institute of Sociology, Chinese Academy of Social Sciences

The Chinese Economy in a Global Context

Stephen Friedman, Chairman, Stone Point Capital LLC; Chairman, President's Foreign Intelligence Advisory Board; former Director, National Economic Council and Assistant to the President for Economic Policy

SUNDAY, AUGUST 6

**DAY II: ENERGY, THE ENVIRONMENT,
AND OTHER TRANSNATIONAL CHALLENGES**

Session I:

China's Thirst for Energy: An American Perspective on Global Energy Markets

Presenter

- John Podesta, President and CEO, Center for American Progress; former Chief of Staff, The White House

-
- John Deutch, Institute Professor, Massachusetts Institute of Technology; former Director of Central Intelligence and Deputy Secretary of Defense

Session II:

The Public Health Challenges Confronting China: HIV/AIDS and Avian Flu

Presenter

- Margaret Hamburg, Senior Scientist, Nuclear Threat Initiative; former Assistant Secretary for Planning and Evaluation, the U.S. Department of Health and Human Services

Strategic Interventions

Chinese Foreign Policy and the Global Imperative of Energy

Cui Liru, President, China Institute of Contemporary International Relations; former Director of the Division of American Studies, CICIR, and Director General of the Institute of World Information, the State Information Center

The Chinese Environment: “It’s Best Not to Breathe the Air”

Ma Jun, Director, Institute of Public Environment; Yale World Fellow

China Celebration Dinner

Hosted by Robert A. Hefner III, Founder, Owner, and Managing Partner, The GHK Company; and MeiLi Hefner

Keynote Speaker

- Robert Zoellick, Vice Chairman, International, Goldman Sachs; former Deputy Secretary of State and U.S. Trade Representative

MONDAY, AUGUST 7

DAY III: OF SOFT POWER AND CHINA’S PEACEFUL RISE

Session I:

China’s Popular Culture: Of Pop Stars, Matinee Idols, and Youth Trends

Presenter

- Zha Jianying, Writer; China Director, India China Institute, The New School

Session II:**What Does China Really Want *In* and *From* the World?****Presenter**

- Wang Jisi, Dean of the School of International Studies, Peking University; former Director of the Institute of American Studies, Chinese Academy of Social Sciences

Strategic Intervention**An American Perspective on Chinese Dreams**

Jeffrey Bader, Director, the China Initiative, Senior Fellow, Foreign Policy Studies, The Brookings Institution; former Ambassador to Namibia, Deputy Assistant Secretary of State for East Asian and Pacific Affairs, and Director of Asian Affairs, National Security Council

2006 ASG Leadership Award Dinner

Hosted by Leah Zell Wanger, President, LZW Group; and Ralph Wanger, Founder, Wanger Asset Management

Award Recipient

- Madeleine Albright, Principal, The Albright Group; Founder, Aspen Atlantic Group; former Secretary of State

TUESDAY, AUGUST 8

DAY IV: STRATEGIC COMPETITION, REGIONAL REACTIONS, AND GLOBAL GAMBITS
--

Briefing**How China Sees the World and Debates about Its Rise in Global Politics: Schools of Thought in China's Foreign Policy and National Security Leadership**

- David Gordon, Vice Chairman, National Intelligence Council; former Director, Office of Transnational Issues, Central Intelligence Agency

Session I:**China Rising: The View from the Neighbors from Japan to India****Presenter**

- Michael Green, Associate Professor, Edmund A. Walsh School of Foreign Service, Georgetown University; Senior Adviser and Japan Chair, Center for Strategic and International Studies; former Senior Director for Asian Affairs, National Security Council

Session II:

The Essential Elements of China's New Military Capabilities: What They Mean for the United States

Presenters

- Ashton Carter, Co-Director, Preventive Defense Project; Ford Foundation Professor of Science & International Affairs, John F. Kennedy School of Government, Harvard University; former Assistant Secretary of Defense for International Security Policy
- William Perry, Co-Director, Preventive Defense Project; Michael and Barbara Berberian Professor, Center for International Security and Arms Control, Stanford University; former Secretary of Defense

Strategic Intervention

Troubles in the Taiwan Strait?

Richard Bush, Director, Center for Northeast Asian Policy Studies; Senior Fellow, Foreign Policy Studies, The Brookings Institution; former Chairman of the Board and Managing Director, American Institute in Taiwan

WEDNESDAY, AUGUST 9

<p>DAY V: CONSTRUCTING STRATEGIES: POSSIBLE COOPERATION OR INEVITABLE CONFLICT</p>

Session I:

The Case for Cooperation and Manageability

Presenter

- Kenneth Lieberthal, Arthur F. Thurnau Professor of Political Science, William Davidson Professor of Business Administration, University of Michigan; former Special Assistant to the President for National Security Affairs and Senior Director for Asia, National Security Council

Session II:

The Potential for Misunderstanding and Flaring Tensions

Presenter

- Randall Schriver, Principal, Armitage International; former Deputy Assistant Secretary of State for East Asian and Pacific Affairs

Session III:

The Challenges in Constructing Political Consensus: Thunder on the Right and Disagreements on the Left

Presenter

- Thomas Donilon, Partner, O'Melveny & Myers LLP; former Assistant Secretary of State for Public Affairs

Concluding Remarks:

Presenters

- Fareed Zakaria, Editor, Newsweek International; former Managing Editor, Foreign Affairs
- Nicholas Kristof, Columnist, The New York Times; former Associate Managing Editor, The New York Times

Director's Wrap-Up

- Kurt Campbell, Senior Vice President, Henry Kissinger Chair, Director, International Security, Center for Strategic and International Studies; Director, Aspen Strategy Group; former Deputy Assistant Secretary of Defense for Asia and the Pacific and Director, National Security Council

Scene Setter and Discussion Guide

**ASPEN STRATEGY GROUP WORKSHOP
“CHINA’S MARCH ON THE 21ST CENTURY”**

SCENE SETTER AND DISCUSSION GUIDE

KURT M. CAMPBELL

DIRECTOR, ASPEN STRATEGY GROUP

SENIOR VICE PRESIDENT, HENRY A. KISSINGER CHAIR

DIRECTOR OF INTERNATIONAL SECURITY PROGRAM

CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES



“The transfer of power from West to East is gathering pace and soon will dramatically change the context for dealing with international challenges—as well as the challenges themselves. Many in the West are already aware of Asia’s growing strength. This awareness, however, has not yet been translated into preparedness.”

- James F. Hoge, Jr. writing in *Foreign Affairs*, July 2004

After a protracted period of uncertainty concerning the nature of the foreign policy challenges that are likely to confront the nation over the course of first half of the 21st century, twin challenges are now coming into sharper relief. For the next generation or more, Americans will be confronted by two overriding (and possibly overwhelming) challenges in the conduct of American foreign policy: how to more effectively wage a long, twilight struggle against violent Islamic fundamentalists, and at the same time cope with the almost certain rise to great power status of China.

Each task taken on its own would be daunting and consuming, but coming concurrently, as they inevitably will, these challenges are likely to prove close to overwhelming for a government apparatus and national mindset better suited to singular efforts. Our Aspen Strategy Group (ASG) discussions over the last few years, if anything, reflect just how much work is yet to be done on a myriad of matters related to the terrorism nexus, including improving many aspects of homeland security, implementing various nonproliferation protocols, tracking the movement of terrorists and their backers, and helping create more opportunities and hope for an entire generation of disaffected Muslims living across the Middle East, Southeast Asia, and Western Europe. Added to this complex set of tasks increasingly are challenges coming from the East. Together, these two international challenges – China and the jihadist threat – comprise a sharp departure from previous foreign policy pursuits – such as the nearly half-century struggle to confront and contain Soviet expansionism – for which the United States is as yet largely unprepared, militarily, psychologically, or politically. The potential threat in this developing scenario is that the United States will find itself overextended in its national capacities to meet both challenges concurrently.

Over the course of the last several years, the ASG has considered issues more associated with the jihadist threat – the proliferation challenge, the status of Middle East politics, and the changing nature of global terrorism – but this summer our collective attention turns toward the East and the looming giant in the international arena: China. Over the course of five days, we explored the emerging dynamics of China’s cacophonous domestic scene, the essential elements of its global ascendance, and examine how China’s neighbors and other states are responding to the challenge.

With the assistance of several noted specialists on and from China, the ASG has sought to orchestrate both a deeper learning experience about a country all Americans need to understand better, and to create a chance to explore American policy approaches for how best to cooperate (or simply coexist) with China in the time ahead. Chinese guests will be with us for the first three days of our deliberations; subsequently ASG members and their invited guests will grapple with policy options for how best to deal with China during the final two days of our discussions. Aspiring China seeks to play a greater role on the global stage and, like the previous rising states of the first half of the last century, Germany and Japan, seeks redress of historical grievances, is motivated by a fervent nationalism, and wants to claim its place in the sun (note to Japan, not the *Rising Sun*). China’s rise comprises roughly half of the challenge ahead for this generation of policy practitioners.

This is, indeed, the first time in the nation’s history that foreign policy makers have had to cope with two such vexing and dissimilar challenges simultaneously. While it is true that during World War II the United States fought on two fronts in the Atlantic and Pacific against two very different foes – Nazi Germany and Imperial Japan – the military power employed to defeat the Axis was largely fungible and the tactics employed on each front were similar, adjusting for the inevitable variations of geography, climate, and terrain. Then, during the Cold War, the undeniable shaping experience of the last generation of foreign policy and national security practitioners, the United States faced one overarching and organizing foreign policy challenge coming from the Soviet Union. A singularity of purpose in the formulation and execution of American foreign policy has been the overriding experience for most of our history, allowing for a greater unity of effort and a lack of competing demands.

This era is now undeniably over, as the United States confronts two extremely varied sets of demands, one driven by stateless jihadist warriors and the other by a rising commercial, political, and military giant in the East.

Ever since the galvanizing attacks of 9/11, the United States has in turn attacked (literally) the problem of violent jihadism, primarily through the application of military power in Afghanistan and Iraq (the latter now inextricably linked to the terror matrix, largely as a consequence of American actions). The mostly unanticipated demands of the martial campaigns in the Middle East have had a corollary consequence beyond simply bogging down in unforgiving urban battlefields. The United States has been almost inevitably preoccupied away from the rapidly changing strategic landscape of Asia at a time of enormous consequence, when China is making great strides in its military modernization, commercial conquests, diplomatic inroads, and application of its new found “soft power.”

Rarely in history has a rising power gained such prominence in the international system at least partially as a consequence of the actions of – and at the expense of – the dominant power, in this case the United States. Indeed, aspects of China’s rise have been accomplished without even an accompanying awareness in large part inside the United States. China’s ascent has arguably been among the most rapid and consequential in history, in many ways rivaling or even surpassing the

significance of America's rise in stature during the first two decades of the last century. American diplomatic talking points continue to stress the need to "manage" China's emergence as a dominant power, but it is perhaps more apt to describe a China that is increasingly attempting to manage American perceptions and actions while China seeks to consolidate its new found gains globally.

"Please explain to me how your President has traveled around the United States during political campaigns and for numerous events on Iraq and he is never demonstrated against or publicly embarrassed. Yet our President comes to the White House for just one public meeting after months of preparation and there is a disruption lasting several minutes that causes us great humiliation. Explain to me, how can this happen?"

- A senior Chinese Ministry of Foreign Affairs official traveling with President Hu Jintao for the Washington summit with President Bush, Spring 2006

What is perhaps most impressive about the recent summit between Presidents Bush and Hu in Washington, D.C., was not how many things went badly wrong during the brief visit, but how quickly both leaders and their respective teams of advisors put a brave face on, and set about purposefully to highlight the upsides of a clearly disappointing encounter. It was as if both sides looked deeply into an abyss, looked up, and then together decided to soldier on. The protracted hectoring by a Falun Gong journalist, the mix-up on the official title of the People's Republic of China (you say tomato, I say Taiwan), and the inadvertent yank administered to President Hu as he prepared to dismount the stage, all received the lion's share of the attention in the commentary over diplomatic snubs and shoddy planning. But the real story of the disconnect between China and the United States concerned the mismatched expectations of the two sides.

The United States had a substantive agenda, seeking assistance from Beijing on a host of thorny problems, including help in reigning in North Korea's nuclear ambitions and dealing with Iran's refusal to suspend its own nuclear brinkmanship. Instead, Chinese leaders, as is their habit, sought a largely symbolic summit filled with the pomp, pageantry, and 21-gun salutes for all the world (and especially Chinese citizens) to see. Substantive deliberations were largely to be avoided during these meetings, particularly as the American hosts had refused to offer a state dinner or other such high level courtesies – signs of respect that Chinese travelers in business and diplomacy have come to expect elsewhere in the world. This clash in expectations played out in sometimes tense exchanges between the two leaders, leaving the Chinese visitors, especially, to subsequently highlight the wonderful reception they received in the *other* Washington (Hu had made a quick stop in Seattle before coming East to meet with a host of corporate titans, each more eager than the last to secure a special dispensation or a personal invitation to visit China).

However, despite these setbacks that illustrate the increasingly high stakes (and often high risks) characteristics of Sino-American summitry, both sides have taken pains to recover and move on. This is a particularly impressive step for China who has been known to nurse grievances of this kind. Unlike the aftermath of the Belgrade embassy bombing when China was awash with rumors about shadowy governmental cabals conspiring to bomb the diplomatic compound, this time there was remarkable little conspiracy talk about how a ruthlessly efficient White House carefully orchestrated a series of grave indignities. Instead, there was President Bush and President Hu just a few weeks later at the G-9 meeting in St. Petersburg smiling broadly for the cameras and taking (at least little) steps to find common approaches and cooperation on precisely those vexing issues like North Korea and Iran.

“Cancelled due to Iraq”

- A hand-written note scrawled across an announcement of a public symposium on the U.S. role in Asia, held at the SAIS auditorium in April 2002

In recent years it is true that considerations of the import of China’s rise have received short shrift among the strategic commentariat who continue to be more urgently focused on Iraq and the larger war on terror, particularly given the short term stakes involved. Despite this general competition for time and attention between the two, it is also true that both the larger war on terror and the challenge of China are now subjects of profound reevaluation in policy circles. The United States is coming to the end of the first phases of strategies designed to deal with each international problem, somewhat concerned by the results in both cases.

The United States has practiced a policy of “engagement” towards China for over two decades, a somewhat ill-defined approach based on commercial interaction designed to draw the Middle Kingdom into the global community of nations but largely free from clear metrics of success or failure. The United States has hedged its bets to be sure, by maintaining a robust military presence in the Asia Pacific region, but the “engagement” and “hedging” aspects of the American approach are not well integrated, and the United States must begin to consider how best to interact with China in the next phase of relations.

Elements of the engagement and hedging components of U.S. strategy can often be glimpsed in important American speeches and strategic documents. The former sentiment is best exemplified most recently by Bob Zoellick’s important “stakeholder” speech. Perhaps revealingly, the “stakeholder” term came into vogue during the western expansion in the United States during the 1840s, when stakeholders made claims to land and gold in a lawless, speculative, boom and bust environment. Indeed, some of the very characteristics that drive Chinese capitalism today. The hedging component is illustrated most aptly by Don Rumsfeld’s recent Quadrennial Defense Review. The common denominator in each of these schools of thought is the notion that the United States is and will remain the dominant player in the Asian Pacific region. But some are quietly beginning to wonder whether the U.S. policy of “engagement” has succeeded too well and that China is now beginning to get the better of the United States in open political and commercial contests.

In the war on terror, the first phase of our campaign against the jihadists has relied too heavily on military power and not enough on an integrated political strategy where military actions are but a component part in an overall strategic approach. In the next phase, the United States and its allies must find more cost effective methods and multifaceted approaches to deal with terrorists embedded in sympathetic communities. The problems of “draining the swamps” of the Middle East and easing the resentments of disenfranchised Muslim populations in Europe and elsewhere are daunting and with no clear cut, short-term solutions.

Each of these major international challenges involves fully utilizing all the tools of a successful foreign policy – cultivation of allies and friends, targeted use of foreign assistance, prudent investments in and uses of military power, developing more robust intelligence capabilities, initiating more effective public education, and demonstrating sustained political will – in order to achieve success. Yet, beyond these generalities, there are major differences in the details of each case.

For China, the United States must maintain a forward deployed military presence in the region that is both reassuring to friends and a reminder to others that we remain the ultimate guarantor of

peace and stability. Capital ships, stealthy submarines, expeditionary marine forces, and dominant airpower will likely be the most effective tools of military power in a range of Asian scenarios where an American role might prove decisive. The United States must also conduct a nuanced diplomacy that eases regional tensions on the Korean peninsula and between China and Taiwan while not comprising relations with friends and allies.

We must continue to revitalize our alliances with Japan, South Korea, Singapore, and Australia, and diversify our military presence in creative ways.

The United States must also be much more active in a wide range of existing and arriving multilateral institutions across the region. Chinese language skills will be important at every level of government and military service, as will a general knowledge of how Asia works. Most importantly, the United States must begin to rebalance its energies more evenly between the Middle East and Asia, because a continuing preoccupation in the Middle East will have negative long-term ramifications for the American position in the region. These setbacks would be difficult to recover from if we wait to re-engage only after the current unpleasantness in Iraq and elsewhere is behind us.

The United States must balance its energies more evenly between the Middle East and Asia.

The United States will require a very different set of capacities for dealing with the ongoing war on terrorism as it heads into its next phase. Effective intelligence and early warning of possible attacks will be at a premium for the foreseeable future. Enhanced special force capabilities and rapid strike capabilities will be essential for the conduct of effective operations against shadowy terrorist targets. Major aid and economic programs designed to address profound problems of underemployment in the Islamic world will be of critical importance. A nuanced strategy of promoting political reform throughout the Middle East will require both a sustained commitment and an appreciation for local conditions. Greater training in a host of relatively obscure languages – Arabic, Farsi, and a host of Indonesian dialects – will be important for achieving more effective intelligence capabilities and making better political assessments. Homeland security investments to deal with prevention and consequence management will also require serious and sustained government led investments.

These concurrent challenges, in short, will require starkly different government efforts and capacities. Either one on its own would be daunting; taken together, managing the rise of China and the enduring war on terrorism are likely to prove overwhelming. Given that the violent struggle with the Islamic jihadists is now an inescapable feature of American foreign policy and homeland security efforts, while relations with China involve a complex mix of cooperation and competition but are not necessarily destined to degenerate into open hostility, perhaps it will be prudent for American strategists to consider how best to phase and shape these simultaneous challenges. For instance, Chinese cooperation in the global war on terrorism should be a main feature in the American diplomatic strategy with Beijing, given that the PRC has as much to lose from the jihadist's success as the United States. Southeast Asia is likely to be a major battleground for hearts and minds between moderate Muslims and radical Islamic instigators, and China has a major stake in seeing the former prevail in this major struggle raging inside Islam and playing out in a number of Asian states.

The fight with the jihadists is unavoidable, while a military or protracted political confrontation with China is not preordained. A wise American diplomacy would appreciate these distinctions

and seek to develop its strategy accordingly. While the United States will need to continue its hedging strategy in Asia and to put more pressure on China for greater transparency, democratization, and regional confidence building, there are clear grounds for a sustained strategic cooperation between Washington and Beijing where one of the potential benefits would be a united front against the global jihadist threat. This does not mean that areas of competition and outright hostility between the two great powers of Asia will disappear – they will not – but instead, that our differences can and should be managed in order to focus on more immediate and shared threats. This may be both prudent and necessary as it is not clear that the United States has the political inclination and resources to deal with two, all-out challenges concurrently.

Nevertheless, the best assessment here is that two dominating and different challenges will dominate our foreign policy agenda for at least the next generation and there is an important domestic component needed for implementing an effective national strategy to stay the course. Constructing a durable, bipartisan consensus on the overarching foreign policy approach to these twin challenges is essential and inescapable. A degree of bipartisanship was a recurring feature of much of the Cold War era in American domestic politics and bitter divisions often stopped “at the water’s edge” in Senator Vandenburg’s immortal words. Bipartisanship has been conspicuously absent in current foreign policy debates and this internal divisiveness arguably hampers our effectiveness in the formulation and execution of American foreign policy. Given the magnitude of what lies ahead, a concerted effort to rediscover some common ground in American domestic politics (at least when it comes to foreign policy) may indeed be one of the most important ingredients for a successful balancing act between these two huge challenges facing the country in the coming decades.

“They seek quite simply to adjust the status quo in Asia in their direction and to take advantage of American exertions elsewhere ... They are in the midst of transforming their considerable commercial power into new military capabilities.”

- George Friedman and Meredith Lebard, introducing their new book, *The Coming War with Japan*, during a talk in 1991

It is quite possible that China possesses a profound insight into the American strategic character that we ourselves do not fully comprehend or appreciate. A not well recognized feature of America’s international character is our predisposition to predominance. Simply put, the United States will not yield its position or prerogatives gracefully to another rising state in the international order, no matter the circumstances or the nature of the arriving regime. This desire to sustain American preeminence and deter potential challengers to its dominant status is quite clearly articulated in the 2002 National Security Strategy of the United States.

While the clear inspiration for this current determination to remain on top is China, these sentiments are not unique to the current competition for global power and prestige with Beijing. Indeed, at the end of the Cold War, there was much strategic commentary about the need to prevent the undue increase in influence and potential challenges to American authority coming from two other states seen at the time to be on the march – an economically vibrant Japan and a newly reunified Germany (and when China received scarcely a sideways glance). This suggests that while concerns over democracy and human rights animate our worries over China’s rise, these anxieties ultimately are not determinative. This is at least a partial explanation for why China featured first

the notion of “peaceful rise” and later “peaceful development” – when the “rise” in the first articulation was thought to unduly attract the wrong kind of attention – as its global diplomatic calling card. In addition, China has sought to keep the Asian neighborhood quiet, trying (unsuccessfully) to keep North Korea largely subdued, Southeast Asia sanguine, and everyone making money, so that the United States would not be unduly disturbed from its important business elsewhere.

The essential feature of this hegemonic parable is that the United States will not experience transitions in its essential power relationships easily, and appreciating this essential truth will be an important ingredient in constructing an effective policy – both for China and the United States – into the future.

The truth is that history is littered with failed strategies for dealing with rising states. The British and French attempts to contain a rising Imperial Germany at the turn of the last century had disastrous consequences as did the American and British acquiescence in not confronting Japanese appetites in other parts of Asia and the Pacific during the 1920s and 1930s. Indeed, the only modern example of a graceful transition of power is between Great Britain and Washington, and the intimate relationship that spanned Washington and Whitehall throughout Britain’s slow decline cannot in any way be construed like the complex, sometimes distrustful links that currently exist between Beijing and Washington.

It is also true that we must approach the problem of making hegemonic predictions in Asia with some humility and trepidation because practitioners, commentators and leaders have got it wrong far more often than right in recent times. It was scarcely a generation ago that Mikhail Gorbachev delivered an important speech in Vladivostok in 1986 that many felt would usher in an era of Soviet dominance in the Pacific. That was followed by a period when it was accepted as fact that Japan would become the dominant player in the international arena and Tokyo would inevitably transform its considerable economic power into political and military muscle, perhaps replacing the United States as the new Number 1 in the world. Throughout this period there was also a deep belief that America was in the midst of a tragic and irreversible decline as a result of a costly and draining Cold War competition. This most recent period has been animated by the belief of an almost preordained Chinese ascent – even though Beijing faces enormous domestic and international challenges that could derail its course. Already there are prognosticators in Asia that have downgraded the long-term prospects for China’s rise who are instead anticipating the next new ascender on the international scene: India.

Three distinguished speakers were about to deliver their respective thoughts on the almost existential subject of China’s meaning in a global context. The first speaker, a folksy four star admiral who had just completed the first month of his first posting to the Asia Pacific region, informed the crowd that, “You know, China is a really big country,” with all the certitude of new found knowledge. The second speaker was a well respected Asian commentator from a major newspaper with decades of Asian experience and he proceeded to deliver a very lengthy and deeply nuanced analysis of China’s foreign and national security policy. Finally it was time for the last speaker, an elderly academic considered by many to be the greatest Sinologist alive, but because time was short he was asked to keep his comments relatively brief. With a bemused smile he put aside his pages of notes and summed up both his presentation and a lifetime of study with a simple mantra. “China,” he said, “is a big country.”

- From a recent symposium on China in the world

The recognition of China's vastness lies at the beginning of our journey towards understanding and at the very end of our accumulated knowledge. That China is big is at once a basic banality and a profound truth (even President George W. Bush has offered up the occasional commentary on China's size, most recently when he observed to Chinese President Hu Jintao in what was meant to be a private aside at the recent G-8 meetings in St. Petersburg that, "it takes eight hours to fly from here to China ... China is a big country!"). Scarcely a news account can be found on the China phenomena that does not extol the virtues of its bigness – the largest population, biggest producer and consumer of cement and steel, largest work force, biggest dam, greatest Great Wall,

China is regarded by most as a great power today not only for what it is but for what many just assume it will become.

etc. – yet all the discussion of China's size often obscures subtle aspects of its society, such as the changing dynamics in the Chinese family, the re-embracing of spirituality, growing resentments among poorer workers, and the yearnings of a rapidly emerging middle class.

limit its power and ambitions, such as the vast poverty, growing inequality, and inefficient public sector. China is in many ways can only be described as aspiring to be a great power – given all these profound challenges that must first be overcome. Still, China is regarded by most as a great power today not only for what it is but for what many just assume it will become.

Indeed, all the talk of bigness also hides the many shortcomings in China today that

The drama and audaciousness of what China is trying to accomplish in its domestic economy and internal society suggests that for at least the near term, Chinese leaders themselves will be pre-occupied somewhat themselves away from a deep engagement in global politics. Yet this reality should not lead Americans or other Asian neighbors into a false sense of security. The increasing demands for global sources of energy, the need to increasingly project power to protect its lines of trade and communication, and managing China's rapid globalization each carry with them the risks of conflict and misunderstanding. While it is true that China does not appear to have the territorial ambitions of Stalin's Russia, there are ample examples of how domestic imperatives could well drive global adventurism.

"There are few problems, or indeed solutions, in contemporary international relations that do not in some important way require engagement with China. Americans must begin to accommodate themselves to this new reality of foreign policy."

- Henry A. Kissinger, remarks to the CSIS Board of Advisors, June 2004

The significance of Kissinger's perspective is abundantly clear on a host of global issues, ranging from reigning in North Korea's nuclear ambitions, maintaining stability in South Asia, ensuring predictability in global energy markets, dealing with global climate change, and preparing for the potential of a deadly avian flu outbreak. While the United States and China have only begun to scratch the surface when it comes to actualizing potential collaboration to deal with common global challenges, there is at least a growing appreciation in Washington that many problems just cannot be solved without an active (and positive) Chinese role. This recognition has caused many American lawmakers, strategists, and commentators to want to know more about how China works

and how its global ambitions are evolving. The Aspen Strategy Group seeks to help meet this challenge by providing a thoroughgoing examination of the many facets of China's rise to great power status, including its remarkable economic prowess, purposeful military modernization, the lure of China's culture and history, and its increasingly deft diplomacy on the global stage.

To help facilitate a comprehensive discussion, we have arrayed our papers and presentations around the following schedule of topics.

The first day of our session will be devoted to discussion of the driving force in China today – its economy. We will examine the economic dimension in two segments, principally the domestic components and underpinnings of China's remarkable growth in recent years and then an exploration of its external economic strategy in terms of trade, the search for raw materials, and macroeconomic policy. We will also look at how China's virtually unbounded growth has triggered the largest and most rapid movement of people from a predominantly rural, agrarian existence into new, urban mega-cities in human history.

There is a growing appreciation in Washington that many problems just cannot be solved without an active (and positive) Chinese role.

Our second day will look extensively at how China seeks to meet its current and future energy needs, in terms of petroleum, natural gas, nuclear energy, and renewable sources. Specific attention will be devoted to the role of energy needs with respect to global petroleum reserves in calculations around China's ultimate potential.

The third day of our meetings will focus on some of the potential challenges ahead for China as it struggles with the enormous strains from astonishing growth and increasing globalization. The risks of a global influenza pandemic are inextricably linked to China, both in terms of its possible genetic evolution and its potential human toll. The spread of HIV/AIDS also presents an enormous burden on an already strained public health sector. Further, we will look at the degradation of the Chinese environment and the loss of habitat for scores of endangered species living in increasingly fragile environments.

Our fourth day will be used to explore both how China sees the world and how others are responding to China's accumulation of both hard and soft power. We will examine debates in China about what its global role should be and look at how others in the surrounding region – Japan, Singapore, India, and Korea, among others – are seeking to cope with the big new kid on the block. We will also begin to examine American perspectives on China's rise and discuss how one particular flash point – the Taiwan Straits – remains a source of friction and uncertainty when it comes to the maintenance of peace and stability in the broader Asia Pacific region.

The fifth and final day will be devoted to summing up and synthesis. Two papers will be delivered that explore two very different trajectories for the future of Sino-American relations. One traces a path of coexistence and cooperation over the horizon given the obvious areas of common ground; the other examines a future increasingly marked by tension and miscalculation, as the two great powers of the Pacific find it increasingly difficult to work together. We will also seek to review the increasing difficulties among Republicans and Democrats alike to construct a coherent and popular platform on China in the current political environment. The group will discuss which future

scenario is most plausible and then consider some summations and distillations from the previous days. It is our hope to leave Aspen not only with a fuller appreciation for the many dimensions of China's rise but also with a greater sense for how this impacts the United States and what we need to be doing about it in the larger formulation and execution of American foreign policy.

The Chinese Economy: Making Strides, Going Global

DAY I

DRAGON AT THE CROSSROADS: THE FUTURE OF CHINA'S ECONOMY

DOMINIC BARTON
CHAIRMAN
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DIRECTOR
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After nearly three decades of reform, China has transformed itself from an economically isolated and closed country into a force reshaping the world economy. The statistics are familiar but still staggering. Between 1985 and 2005, China's Gross Domestic Product (GDP) grew from US\$ 304 billion to \$1.88 trillion in real terms. It has become one of the largest manufacturing bases in the world, and consumes roughly one third of the world's iron, steel, and coal, in addition to nearly a quarter of its copper. For a wide range of categories, from mobile phones to beer, China is already one of the largest consumer markets in the world, accumulating a trove of foreign currency reserves that should top \$1 trillion by the end of 2006.

Unlike some observers, we do not believe this remarkable economic transformation is likely to soon grind to a halt. In our view, China's short-term economics appear stable. Yet the Chinese Dragon is entering a critical, transitional decade. While many of the factors that underpinned economic growth remain intact, government and corporate leaders must confront new economic, social, and environmental issues. Importantly, they must decide whether to further strengthen the role of the private sector in allocating capital and driving innovation. Their choices will largely determine whether the recent period of relative stability and prosperity continues, accelerates, or goes dangerously astray.

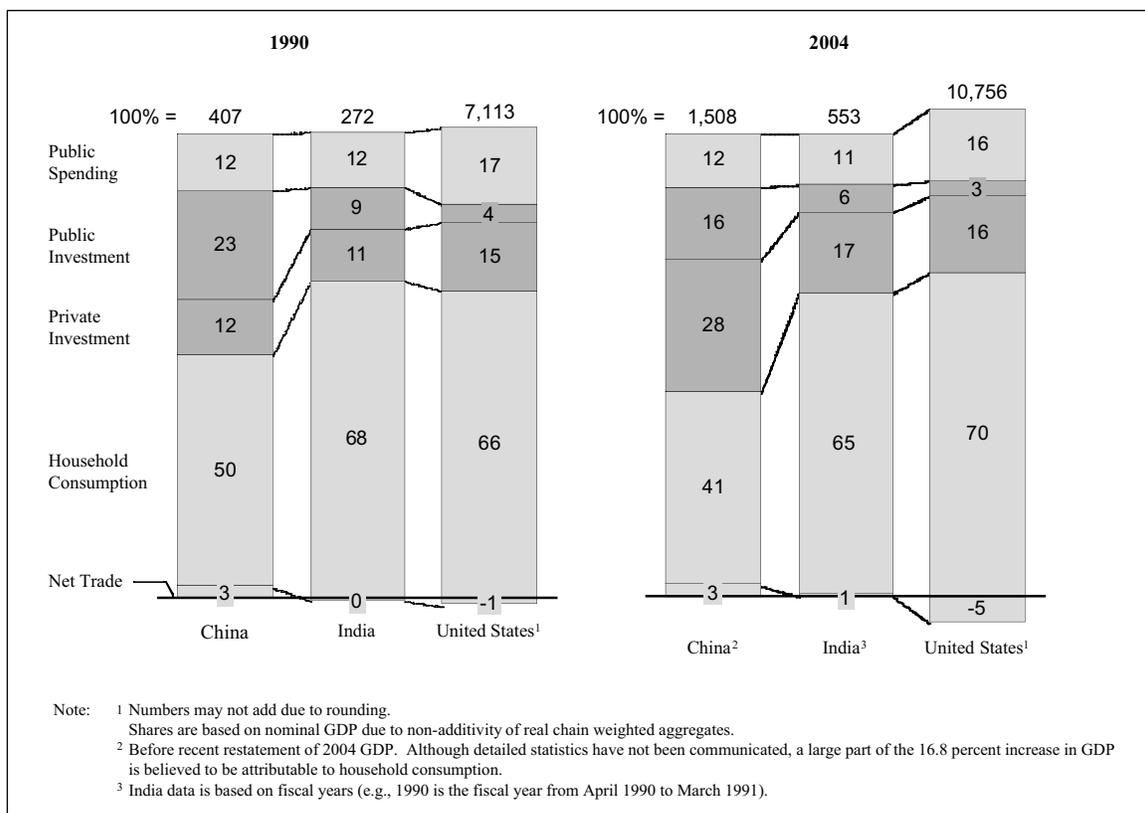
McKinsey & Company has been present in China for the last 20 years, working with Chinese enterprises in both the state and private sectors, as well as with foreign multinationals and the Chinese government at national and local levels. We base our perspective primarily on this micro-economic experience and view of business conduct. In this paper, we will consider the drivers of China's economic growth; the main participants in the corporate sector; three possible scenarios for future development; and how policy makers, particularly in the United States, might respond.

WHAT DRIVES CHINA'S GROWTH?

Across developing markets, and Asia in particular, one factor appears to differentiate the performance of high- and low-growth economies over time: the level of domestic savings. China fits this pattern precisely. Since the government decided in the early 1980s to support the development of a commercialized industrial sector, economic growth has been sustained by generating and then deploying a growing pool of domestic capital against an equally fast-growing pool of investment opportunities. This trend of investment-driven growth is shown in Figure I, below. A huge and steady inflow of foreign capital into export-driven manufacturing has injected additional octane into China's economic engine.

The stability of China's institutional framework, which was initially dominated by the Chinese Communist Party, was vital in generating these critical domestic surpluses and attracting foreign direct investment (FDI). The Chinese diaspora in other parts of Asia were initially the main providers of China's FDI. As for where this capital has been deployed, urbanization has been the primary source of opportunity. Roads, bridges, power, telecommunications, and water infrastructure, along with civil and industrial construction, have consumed more than half of all fixed asset investment. Capital has been collected and disbursed through a highly decentralized mechanism, namely the state-owned banking system, which still accounts for over 60 percent of funds used for investment. The balance comes from internally generated cash flows from operations.

Figure I. Components of GDP in 1990 and 2004: China, India and the United States



Source: China Statistical Yearbook; Central Statistical Organization India; U.S. Bureau of Economic Analysis

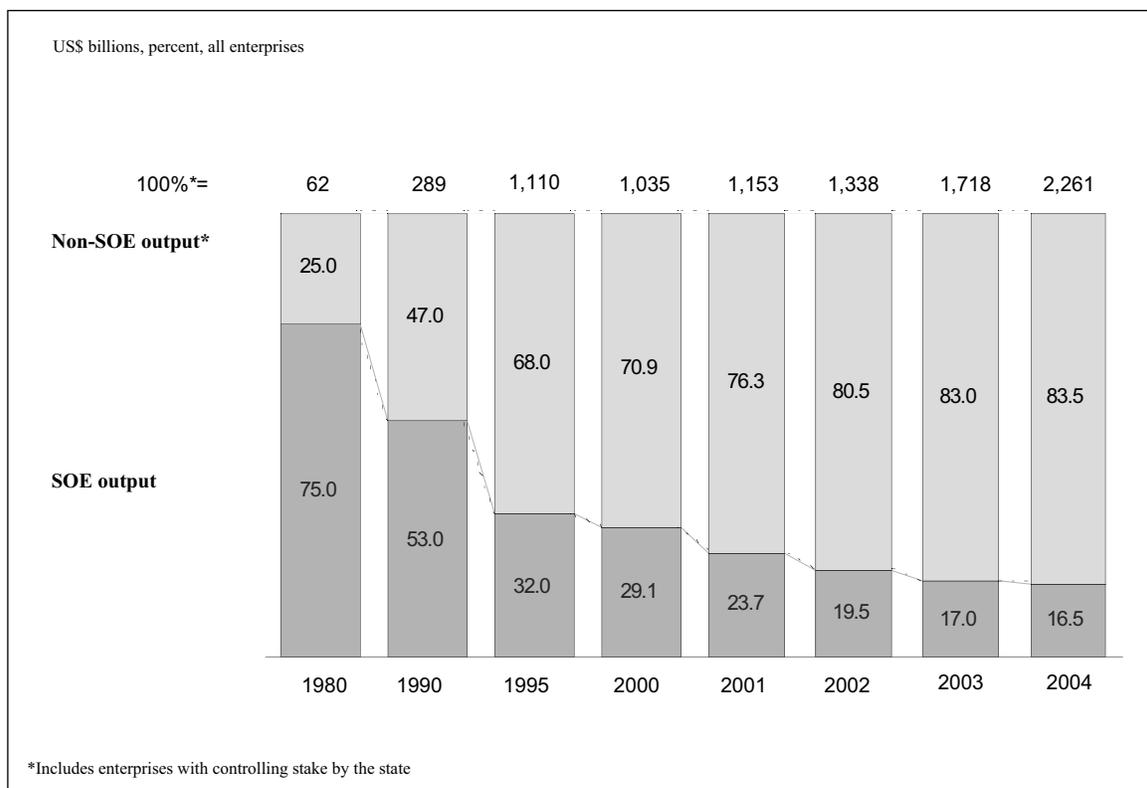
One downside of China's heavy reliance on state bank funding is that when investments are driven by politics rather than efficiency, as many are, productivity growth is inevitably lower than it might otherwise have been. Even so, the country's productivity performance has been nothing short of astonishing. One big reason is that because capital was directed mostly to projects aimed at coping with rapid urbanization – building roads, bridges, and railways between hitherto isolated communities, as well as building entire new communities to accommodate the annual migration of between 20 and 30 million people off the land – even sub-optimal investment has helped deliver a productivity pay-off. The most impressive gains have come in the industrial sector, where productivity has grown at over 12 percent per annum, reflecting the rapid updating of China's

1950s industrial base with 1990s technology. In the last five years, the services sector has also benefited, with productivity increasing by over 8 percent per annum from 1999 to 2004.

Demographics have also been working – and will continue to work, at least for a while – in China's favor. The backbone of the population is in its peak earning years. For example, a much greater proportion of China's top earners are in the 25 to 44 age range than in the United States. The government also continues to push ahead with infrastructure investment. By 2010, China plans to build a further 15,000 km of roads, 42 new small or medium airports, and an additional 160 gigawatts of power generation capacity.

The other, often less recognized, reason for China's productivity miracle is the critical role of its growing and far more efficient private sector, as reflected in Figure II. In 1980, over 80 percent of industrial output came from state-owned enterprises (SOEs). Today, only one-third is generated by SOEs, while total output has grown by over 100 times. While the financing of investment has remained firmly in state hands, the state has in effect outsourced to the private sector project execution and management. There are over 50 million entrepreneurs in China, most of whom started literally with nothing and operate on a far from level playing field. These are the heroes of China's economic development, not only for their self-sacrifice but also for their devotion to achieving profits. While private enterprises contributed over \$30 billion in taxes in 2005, they now account for half of all output and much of net new job creation.

Figure II. China's Industrial Output by Ownership of Enterprises



Source: China Statistical Yearbooks; China Industry Economic Statistical Yearbook; McKinsey Analysis

WHO ARE THE MAIN PARTICIPANTS IN THE CORPORATE SECTOR?

State-Owned Enterprises

SOEs come in many different guises, some controlled by the central government, others by provincial or municipal authorities. Government influence helps explain much of the intra-regional trade friction and protectionism that can distort China's economy. The leaders of state companies are required to run their enterprises with one eye on the market and the other on government priorities. SOEs loom large in what the government regards as strategic sectors such as banking, energy, and telecommunications. The profits they generate – the top 150 earned about \$78 billion in 2005 – give the government massive amounts of capital on which to draw.

However, the protected status of SOEs means they are not exposed to genuine competition and thus remain relatively inefficient. Government has liberalized a range of economic sectors, such as consumer goods, textiles, light industry, machinery, and distribution, reducing the role of SOEs and shedding millions of jobs. The task now is to force the remaining state enterprises to adapt without creating huge economic dislocation. Even in those SOEs now listed on international stock markets (nearly 100 list shares in Hong Kong alone), significant issues remain, such as clarifying the role of the Communist Party in corporate governance and in the running of enterprises.

Large Private Companies

These began to emerge in the early 1990s after an initial wave of experiments with local private ownership. While most have their roots in the state sector, they have come a long way in terms of management and commercial outlook. Their founders are often charismatic and focused on material wealth, often because their parents lived through the economic turbulence of Communist China's early decades. For many large companies, like Meng Niu, the dairy group, or Ping An Insurance, the challenge is to develop a corporation that is distinctively Chinese while also meeting international standards of governance and performance. The result can be a dynamic mixture, infused with "hybrid vigor" – an unusual combination of influences creating a robust, dynamic organism. Others, such as Lenovo, which in 2005 acquired IBM's personal computer business, are committed to creating Chinese-owned multinationals that operate like any other global company.

Small and Medium-Sized Enterprises

More distinctively Chinese than larger private companies, small and medium-sized enterprises (SMEs) make up the bulk of the private sector. Nearly seven million such companies employ around 560 million people. Some are built on a strategic vision. Others are opportunistic, shifting between lines of business according to the whims of a volatile market. Bigger firms sometimes use clusters of dozens of smaller suppliers to hone production processes and pare down costs dramatically.

Note that SMEs operate in a regulatory and licensing environment that is more favorable towards state-owned and larger private enterprises. Corrupt local officials often favor larger companies. Credit is not always available because banks prefer to lend to the state sector. This is a key issue for China's future, since SMEs are a crucible for product and business process innovation.

Foreign-Owned Companies

China is now the world's second destination for FDI after the United States. It has attracted \$500 billion since opening to the outside world and continues to pull in over \$40 billion annually. In marked contrast to Japan, which stayed relatively closed to foreign investment during its postwar boom, China has set the global standard for opening up to FDI and thus reaped the benefits – among them, a more rapid diffusion of advanced technology, management practices, and business processes. Foreign business accounts for 20 percent of its manufacturing employment, 30 percent of revenues, and 60 percent of exports. The technology, energy, and automotive sectors are the main focus of foreign capital, with companies including BP, General Electric, Motorola, Samsung, Siemens, Shell, and Volkswagen among the leading foreign investors.

These companies will not continue to plow billions of dollars into China unless they can earn a decent return. The good news, according to U.S. Department of Commerce data, is that the net income of China and Hong Kong-based affiliates of U.S. companies rose from \$1 billion in 1990 to over \$7 billion in 2005. Moreover, China is growing in importance as not only a location for low-cost manufacturing but also as a market in its own right. Population projections suggest that, over the next two decades, China's middle class will spread rapidly beyond large and medium sized cities. Those categorized as "lower middle class" by global standards in terms of buying power should number some 290 million by 2011, while a second transition should place around 520 million people in the "upper middle class" by 2025.

CHINESE BUSINESS GOES GLOBAL

It is widely recognized that China is changing the game in global industries such as consumer electronics, machine tools, and automotive components. Less well known is the fact that brutal price competition has led to consolidation within China. Now the survivors of this shake-out are focusing on international markets. Companies such as Lenovo, Haier, Midea, Changhong, Bird, and TCL are investing overseas in order to gain market access, building their brands, and acquiring technology and expertise.

In capital-intensive sectors, Chinese companies have been securing international resources for more than a decade. Services companies are also starting to have an impact by, for example, using their market power to influence global technology standards (e.g., China Mobile).

A recent study by the IBM Institute for Business Value and the School of Management at Fudan University sought to identify the Chinese industries and companies most favorably positioned to succeed on the global stage. Using three "filters" – company size (annual revenues of over \$1 billion), industry characteristics (including size as a percentage of GDP, concentration, export intensity, and government support), and company characteristics (leading market position, significant exports, and strong global vision) – researchers came up with a list of 60 companies. Of these, 13 are Privately-Owned Enterprises (POEs). The rest are SOEs. Please see Figure III, below.

Figure III. Selected Chinese Companies with Globalization Potential

SOEs with Globalization Potential			POEs with Globalization Potential		
(Total: 47, 13 highlighted)			(Total: 13)		
Company	Industry	2004 Revenue (US\$ billion)	Company	Industry	2004 Revenue (US\$ billion)
Sinopec	Energy	76.7	Midea Group	White goods	3.9
CNPC (PetroChina)	Energy	69.1	Huawei	Telecom equipment	3.8
BaoSteel	Steel	19.6	Wanxiang	Auto parts	2.5
Haier	White goods	12.2	SVT Group	Electronics	2.3
SAIC	Automobiles	12.1	Younger	Textiles	1.7
Cosco	Logistics	11.3	CHINT Group	Electronics	1.4
CNOOC	Energy	8.6	Wahaha	Beverage	1.4
BOE	Electronics	5.5	Galanz	White goods	1.3
Lenovo*	Computers	5.1	Skyworth	Brown goods	1.3
TCL	Electronics	5.1	People Electric	Electronics	1.2
Hisense	Brown goods	3.3	Aux Group	White goods	1.2
ZTE	Telecom	2.6	Lifan	Motorcycles	0.8
Chery	equipment	0.6	Geely	Automobiles	0.6
	Automobiles				

* March to September 2005 revenues. Lenovo revenues prior to acquisition of the IBM PC division (including the former IBM PC division) were US\$ 6.2 billion.

Source: Company websites

THREE CHALLENGES, THREE SCENARIOS FOR THE DECADE AHEAD

Beijing's leaders face huge challenges in making the decisions that will best ensure China emerges stable and prosperous 10 years from now. Like in every other country, Chinese policy makers have to contend with the risk of external shocks, such as dramatically higher oil prices or a global market meltdown. They also face contentious political issues, such as tensions with Taiwan and a strained geopolitical relationship with Japan. Then there are economic challenges, which in our view fall into three broad categories: mitigating the environmental damage from continued rapid growth; building a better social safety net for Chinese citizens; and confronting several commercial imperatives, most notably pushing ahead with capital market reforms.

On the environment, China already "boasts" 16 of the world's 20 most polluted cities. One third of its major water basins are classified as "highly polluted." According to some projections, if the current growth pattern continues, China in 25 years could be consuming two-thirds of the global grain supply and using up ever more of the world's oil.

As for forging a social safety net, the move away from the old "iron rice bowl" (in which SOEs provided workers with housing, pensions and healthcare) has left tens of millions of urban resi-

dents without pensions. Meanwhile, hundreds of millions of rural Chinese lack basic health coverage. Health ministry surveys find that a significant proportion of the population cannot afford basic health services.

China's corporate leaders face equally daunting challenges. They have grown up in an environment of booming demand, relatively limited competition, and fairly indiscriminating consumers. All this is changing. Demand is maturing and migrating to more sophisticated customers. The era of triple digit growth in many appliance markets, for example, is over as consumers settle into more of a replacement cycle. Meanwhile, overcapacity in most manufacturing sectors means that low cost is no longer a differentiator. In order to retain customer loyalty, companies will need to manufacture at low cost while also meeting global quality standards.

**Nothing is more crucial
than reform of China's
financial system.**

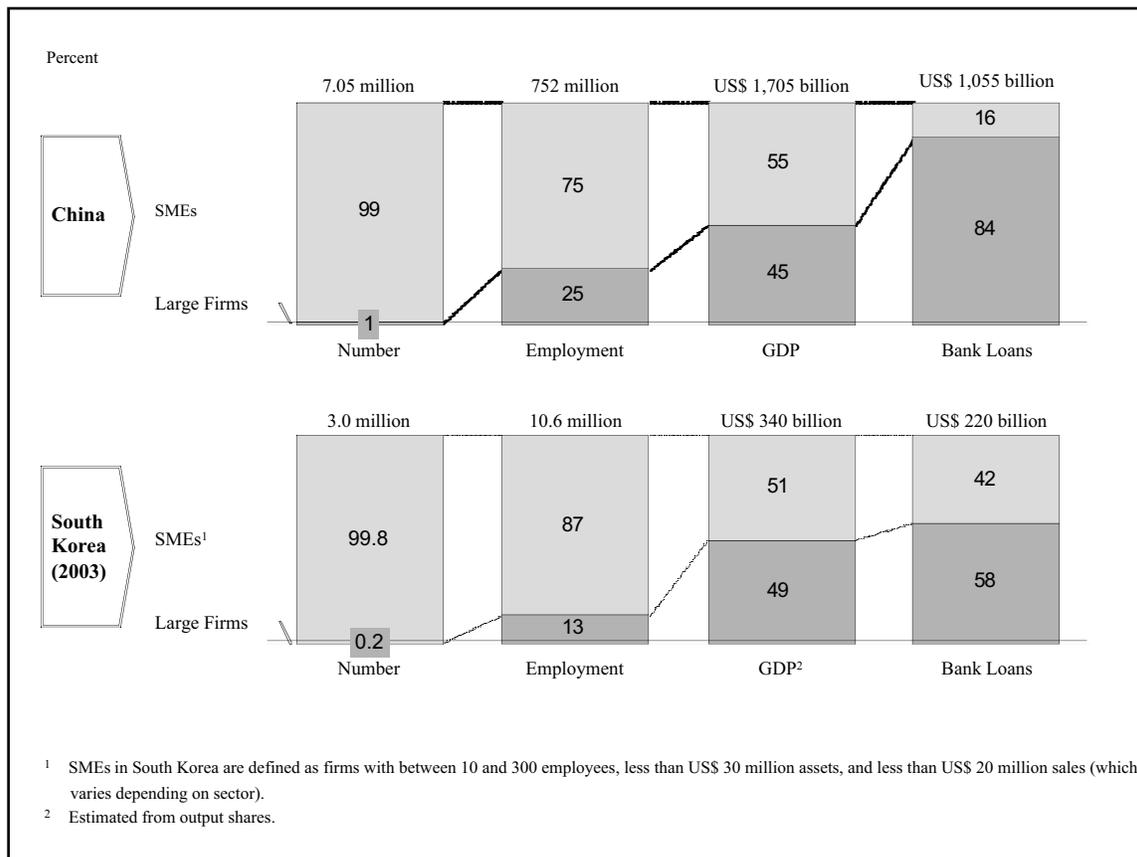
Our experience is that many Chinese companies are ill-prepared to meet this era of tougher global competition. They tend to be much smaller than their global counterparts. Haier, the largest Chinese electronics company, is less than one-tenth the size of Siemens. Research and development (R&D) capabilities are weak: Chinese companies spend less than 3 percent of revenues on R&D, compared to 5 percent globally. Chinese companies are also overly dependent on their domestic market, with more than 70 percent of revenues coming from sales within China. In contrast, among the top 10 global electronics companies, the revenue share of the largest single country is less than 30 percent.

The dislocation of China's education system through political turmoil in the past, and its inability to keep pace with demand, has led to a debilitating shortage of top-flight managers. McKinsey research suggests that Chinese companies will require 75,000 leaders over the next 10 to 15 years in order to meet their global aspirations. We estimate the current supply at only 3,000 to 5,000.

In order to make progress on all of these fronts, nothing is more crucial than reform of China's financial system, which remains dominated by the Big Four state banks. While these institutions have made strides towards cleaning up their nonperforming loans and strengthening corporate governance, misallocation of capital continues on a grand scale. Recent research by the McKinsey Global Institute shows that the cost to the economy of nonperforming loans is small compared to the cost of loans to underperforming ventures that yield only negligible returns.

Many of these under-performing ventures are in the state sector. Even as the share of production from SOEs shrivels, wholly and partially state-owned companies continue to absorb most of the funding from the financial system. Yet their productivity level as a group is half that of private companies. Figure IV, below, shows the disproportionate levels of funding to enterprises as reflected by the comparison with South Korean firms.

Figure IV. Comparison of SMEs in China and South Korea



Source: Press Search, RCIC paper by Guojun, 2005; International Finance Corporation (IFC); Korea Federation of Small and Medium Business; McKinsey Global Institute Analysis

The poor performance of SOEs would matter less if China’s banking sector played a smaller role. In market economies, the share of bank deposits in the financial system typically ranges from under 20 percent in the developed West to about 50 percent in emerging markets. In China, banks intermediate nearly 75 percent of all capital. Two and a half decades of hyper-growth have yet to produce robust alternatives. China’s equity and bond markets remain among the smallest in the world. Equity market capitalization, excluding non-tradable, state-owned shares, is equivalent to just 17 percent of GDP, compared with 60 percent or more in other emerging markets. The corporate bond market, meanwhile, is just 1 percent of GDP, compared with an average of 50 percent in other emerging markets. Moreover, China’s capital markets, to the extent that they do raise capital, are in effect closed to all but state-owned companies.

The immaturity of China’s capital markets skews the distribution of financing. Big companies that would normally seek funding from equity and bond investors turn to banks instead. Smaller companies and consumers are crowded out, turning instead to family and friends for credit or to China’s informal finance market, estimated to be \$100 billion, where interest rates are high.

The misallocation of capital and comparatively high cost of financial intermediation, in turn, limit the returns that Chinese households earn on their financial assets. Chinese households hold

86 percent of their financial assets in low-yielding bank deposits. Given the low average returns earned on Chinese equity and bonds, and their high volatility, the choice is rational. However, over the past 10 years, returns on Chinese households' financial assets increased just 0.5 percent a year after inflation. In contrast, Indian households earned 1.7 percent and South Korean ones 1.8 percent. If real returns in China doubled – a reasonable goal – Chinese households would gain \$10 billion annually. In the long term, this might allow them to consume more and save less, a shift that would improve living standards and allow China to achieve more balanced and sustainable growth.

China's efforts to globalize its companies are as much about psychology as economics.

The benefits of capital market reform, therefore, would be substantial. We estimate that simply increasing the operating efficiency of China's financial institutions and improving the mix of financing vehicles would boost GDP by up to \$62 billion annually, an increase of more than 3 percent of current GDP. The far bigger pay-off comes if reforms also enable a larger share of funding to go to more productive private enterprises. In that case, we calculate that the subsequent increase in investment efficiency would raise GDP by up to \$259 billion annually, an increase of more than 13 percent of current GDP.

How will this all play out? Our crystal ball is no more reliable than any other observer's. Still, we believe there are three possible paths China could take.

At one extreme, the state could fail to meet expectations in a dramatic way: the "Anarchic China" scenario. The gap between rich and poor continues to widen and urban unrest spirals out of control, while Chinese companies prove unable to sustain growth at higher wage levels. This would lead to a significant drop in growth and a more volatile – and potentially more dangerous – China.

On the other hand, China's government could react to the potential risk of anarchy by maintaining its grip on the financial and social institutions of the country. We call this the "Authoritarian China" scenario. There is still plenty of growth in this scenario thanks to the gains that will continue to arise from continued urbanization. However, efficiency suffers as the private sector cannot break through the glass ceiling of state control. Banking reform slows because bank managers lack incentives and tools to take greater risks by lending to the private sector. In industry, the capital-intensive sectors of the economy fail to commercialize on the model of their light industrial and high-tech cousins, leading to a two-tier economy in which large state enterprises continue to monopolize some key sectors and protective legislation minimizes the degree of international and domestic competition. While such an approach is understandably tempting for a communist party preoccupied with preserving stability, the trouble is that, over time, it merely delays the day of reckoning and will most likely lessen China's ability to cope with its daunting environmental and social challenges.

The best outcome is a steady movement of China towards a market economy, accompanied by an enhancement and liberalization of its social structure: the "Advancing China" scenario. In some respects, this would parallel economic and political developments in South Korea and Taiwan. While there are risks to this scenario – notably, the backlash from elites faced with losing their privileged positions – this path would present the most stable and sustainable outcome, as China develops robust markets that are able to support the development of leading global institutions. This requires the development of national institutions able to meet emerging social challenges better

than the Communist Party can do by itself today – specifically, an independent judiciary to cope with corruption, a liquid capital market to drive managers to achieve world-class levels of performance, and a healthcare system structured to meet the requirements of an aging population and release consumer savings for more consumption. In order to be effective, these new institutions must emerge as genuinely independent entities not open to political manipulation.

If China develops along the lines of the “Advancing” scenario, then competition will pervade the economy and at least some Chinese managers and companies will succeed in making the transition to world-class. Yes, this means that a new set of global competitors will emerge, but it also ensures the rise of a critical constituency for reform and for an expanding market economy within China.

We do not believe it is possible at this point to forecast which of these scenarios will develop over the next decade. But monitoring key indicators will offer valuable clues. The most important from a medium-term perspective is productivity growth. In the shorter term, a substantial fall in the rate of investment would indicate a slowdown in the growth engine. Likewise, any sudden rise in inflation would portend a greater risk of government intervention. Crime and social unrest could be other key indicators of potential slowdowns.

At the company level, we recommend watching the pace of the sell-down in state shares, particularly in so-called strategic sectors like banking and automotive. Regulations on foreign acquisitions and guidance on mergers may come and go, but decisions on the equity structure of major companies have long-lasting implications. Just as important will be the success of Chinese companies in globalizing – a feat none have yet achieved.

HOW MIGHT U.S. POLICY MAKERS RESPOND?

Clearly, China’s economic and social development has huge implications for the United States. We urge policy makers to seek to understand the path of China’s development while maintaining a realistic sense of what the United States, or indeed any country, can do to influence it. Preparing the United States itself for a change in the global economic balance of power may be more fruitful than attempting in vain to aggressively reshape China.

First, we believe that the United States should explore the fullest range of channels for the dialogue of knowledge and culture demanded by China’s evolving world role. It needs to consider whether more Chinese than European history should be taught in schools; whether there is a need for offering more media programming to Chinese broadcasters to tap into huge interest in how U.S. market institutions work; whether the United States is being proactive enough in promoting student exchange to meet future needs for people with knowledge of China. As of 2005, there were around 60,000 Chinese students studying in the United States, while about 10,000 U.S. students were taking courses in Chinese universities.

Second, we suggest a series of initiatives that at a minimum would step up the pace of institutional interactions between China and the United States that ideally would boost the kinds of social and human capital building that are critical to a mutually beneficial long-term relationship. For example, China’s financial markets, legal system, and tax policy must be modernized in support of continued economic growth. U.S. institutions have experience and advice to offer. This is true not only at a government level – it is good news that the U.S. Treasury is now being run by a genuine China expert, ex-Goldman Sachs CEO Hank Paulson – but also at a business level. There is considerable

interest among U.S. financial institutions in taking stakes in European equity markets. Encouraging the New York Stock Exchange or Nasdaq to take a stake in the Shanghai or Shenzhen markets would have tremendous significance for the development of China's financial infrastructure.

But why stop here? Investment in management education could relieve a major constraint on the development of U.S. companies in China. American businesses might think about offering more training and university scholarships to help form a new generation of Chinese managerial talent. For example, they may consider funding 100 new "Eagle-Dragon" scholarships along the lines of the Erasmus Scholarships that the United States and Europe already sponsor. Taking that notion further, the best Chinese companies, such as Lenovo, already understand they cannot take on the world by acting as pure local champions like Samsung or Sony. If we imagine something like a Harvard-Tsinghua Institute for the study of global enterprises, among other things, this organization might explore what it would take to create 100 Lenovos – companies led by U.S. as well as Chinese acquirers.

Preparing our own country for a change in the global economic balance of power may be more fruitful than attempting to reshape China.

Third, there should be a push for international agreements and exchanges to moderate tensions in industrial sectors where China is already an undeniable force. In energy and technology, the United States and China have much to offer each other. These agreements should support the process of company-to-company engagement. For example, Peabody Energy is cooperating with Shenhua Coal to introduce Chinese coal-to-liquids technology in the United States and Peabody's operating expertise in China. On the environment, the potential for cooperation is great. U.S. companies should be encouraged to bring more environmental technology into China, where the demand is certain to be strong. This would bring immediate benefit to U.S. companies, while also creating a Chinese industry aligned from the start with global standards. As in other sectors, encouraging Chinese companies to invest more in intellectual capital, while also making it easier for them to acquire technology, gives China a real stake in the protection of international property rights.

Fourth, the United States must prepare for the impact of China and other low-cost countries on its own economy. There is an understandable tendency to blame "China Inc." for the loss of jobs in certain industries and communities, producing friction on a range of trade issues, most notably on the value of the Chinese currency. The reality, however, is that China's export growth is driven by multinationals, many of them U.S. enterprises. On the other hand, China is now actively seeking investment opportunities in the United States and elsewhere. U.S. municipalities should be lobbying for these investments.

In conclusion, we believe that China's efforts to globalize its companies are as much about psychology as economics. How the United States responds will be critical in reinforcing or undermining China's perceptions and actions. We believe that the U.S. public and private sectors can and should play a critical role in helping shape this system. The change in China's global role is a fundamental feature of this century, and the sooner policy makers embrace this new reality, the better placed they will be to build a strategy designed to cope effectively with its implications.

DAY I

ADJUSTING TO CHINA'S RISE

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In 1994, with the public preoccupation with unbeatable Japan and low-wage Mexico, the U.S. administration conducted a behind-the-scenes, high-level review of China's position and prospects. They concluded that the best single lever for the United States to influence China's domestic and international trajectory as a global power would be a robust World Trade Organization (WTO) accession agreement, if only it were possible to get a reluctant Chinese leadership to move.

Today, political leaders around the world are wrestling with a starkly different question: how cope with a China that is poised to become the world's biggest trader? Accommodate or defy, acquiesce or deny? In just over a decade, Japan is selling more to China than any other country for the first time since 1873, and there is talk of a regional currency arrangement anchored by the yuan rather than the yen. Mexican maquiladoras are losing ground to lower-wage Chinese competitors, and China is challenging the United States as the top destination for FDI.

Looking back, it is hard to isolate the turning point. Was it the Asian financial crisis, when China showed remarkable resolve and stood firm as Japan's currency buckled under pressure? Was it the Chinese leadership's bold decision to embrace WTO reforms in 2000? Or was it the 2001 recession, when China's turbocharged engine helped to restart global growth alongside U.S. stimulus?

Looking forward, China's rise poses a varying mix of opportunities and challenges to its most immediate neighbors and key trading partners, as well as to disparate, distant economies from Mexico to Sudan. The United States and others must adapt their domestic policies and regional and international structures in the face of China's rise, eyeing the prospect of growing strength and the risk of significant disruption with equal wariness. While American political discourse is filled with charges of unfairness and threats, China's neighbors, with the exception of Japan, are quietly and pragmatically reorienting their political and economic networks to accommodate and benefit from China's rise.

EXPORT-LED GROWTH ON STEROIDS

China has been pursuing a classic export-led growth strategy, seemingly on steroids. Key elements are familiar from previous East Asian growth stories: massive redeployment of workers from lower productivity agriculture to more productive labor-intensive manufacturing, careful control

of capital flows, high savings rates, and massive investments in manufacturing export enclaves.² As a result, trade now amounts to 70 percent of China's income. In recent years, export-led growth has been accompanied by a mercantilist drive to accumulate foreign exchange reserves, with the result that they are now approaching a whopping \$1 trillion, facilitated by a current account surplus that is expected to exceed \$170 billion (7 percent of GDP) in 2006.³

This growth strategy also bears the marks of uniquely "Chinese characteristics." Heavy state control of this formerly communist economy has been withdrawn unevenly, so that much of the state-controlled banking sector continues to direct credit primarily to SOEs. The result is both a distorted pattern of capital allocation and a massive overhang (estimated by some at two thirds of GDP) of nonperforming loans, which pose important risks to financial sector development.⁴ The

Trade now amounts to 70 percent of China's income.

legal system for commercial transactions is weak and underdeveloped. Corruption is pervasive, and uneven enforcement at the provincial level creates a permissive environment for rampant intellectual property theft. China's low wages have grown much slower than productivity in most areas,

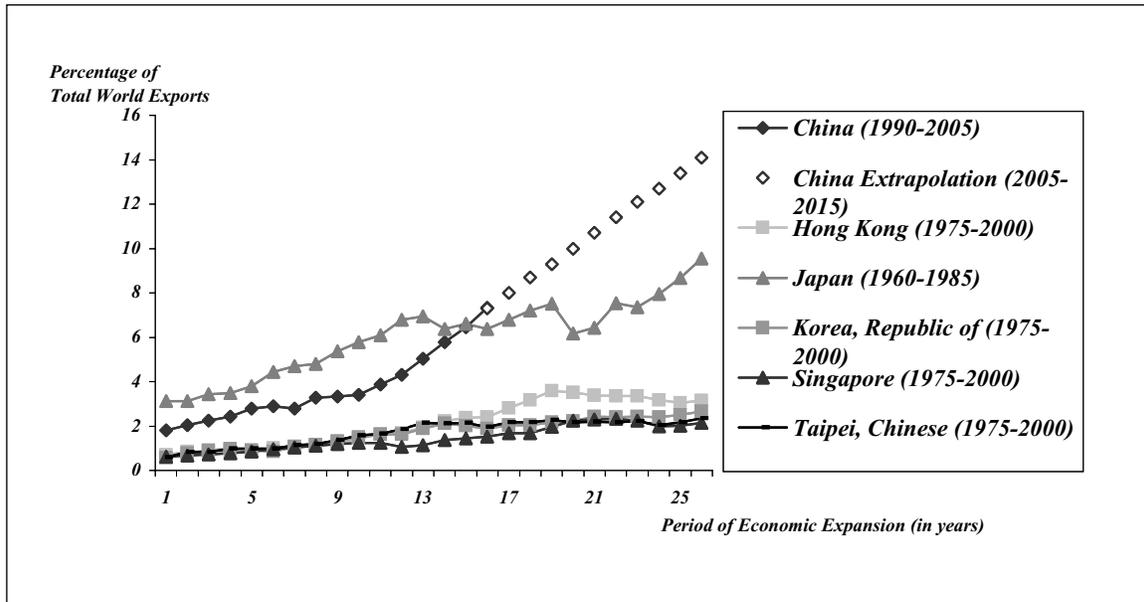
reflecting an enormous overhang of "surplus" labor from rural areas. On the positive side, China's traditional administrative decentralization has permitted policy experiments, such as Export Processing Zones, to be piloted at a local level and then scaled up, as well as beneficial competition between local authorities.

However, China's primary point of uniqueness long predates its communist past. With over one quarter of the world's labor force, China's rise is unique because of its scale. Thomas Friedman quotes Microsoft employees from a research center in Beijing who point out, "Remember, in China when you are one in a million- there are 1,300 other people just like you."⁵ Investments in Chinese production platforms hold the double attraction of serving as low-cost export platforms as well as footholds in a potentially massive market as domestic demand rises.

The speed with which the world's most populous economy has transformed has also been breathtaking. Indeed, by most accounts China's growth performance has no historical precedent, as underscored by the 11.3 percent rate of growth in the first half of 2006. China has maintained 9.6 percent average annual growth for the past 26 years, lifting 250 million people out of poverty.⁶ On human development, China ranks closer to middle income economies than developing economies based on both education and health indicators.⁷

While following a road map similar to that charted first by Japan, and then by the so-called four Asian tigers (South Korea, Taiwan, Singapore, and Hong Kong), China's take-off has been more rapid by many measures, as suggested by the comparative look at export performance in Figure I, below.⁸

Figure I. Exports as a Share of World Trade during Take-Off

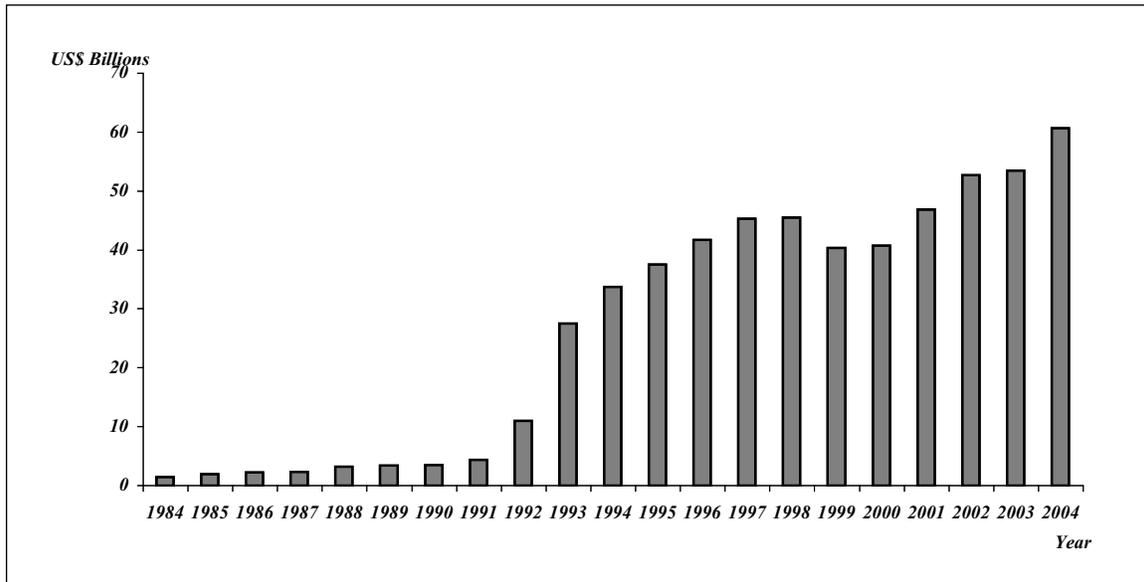


Source: International Monetary Fund (IMF), International Financial Statistics

In contrast to the Japanese model, China has actively solicited FDI, eagerly absorbing the product know-how and managerial skills that foreign multinationals bring. Indeed, it is hard to disentangle the story of China's spectacular rise from that of Wal Mart, which – if it were a country – would be China's seventh largest trading partner.⁹ Partly as a result of developing symbiotic relationships with multinationals in increasingly integrated global supply chains, China has fewer internationally-known brands than Japan at a similar stage in its trajectory, but is well positioned to make that transition as domestic marketing and design skills deepen.¹⁰

China has also absorbed a rapidly increasing share of the world's FDI flows, as shown in below in Figure II. Indeed, by 2003, China was vying with the United States for the number one position globally. As a result, fully half of China's exports are produced by non-Chinese firms and joint ventures located there; the proportion is 90 percent for exports of electronic and IT goods.

Figure II. Foreign Direct Investment in China



Source: United Nations, World Investment Report (Annex Tables), 2005

China’s massive scale risks overwhelming the finer points of its development, which can sound like a cascade of breathless superlatives. Despite impressive achievements, Chinese authorities believe they are navigating an uncertain course fraught with risks. The Minister of Public Security noted that there were 74,000 recorded protests involving 3.8 million people in 2004; they range from farmers protesting inadequate land restitution and environmental degradation, to urban workers protesting evictions and inadequate compensation, to citizens protesting corruption.¹¹ A World Bank report warns that “the acute water shortage and pollution problems in North China will soon become unmanageable with catastrophic consequences for future generations” unless water resources are better managed.¹² Inequality has risen sharply, and public health coverage in rural areas has fallen from 90 percent at the outset of reforms to 10 percent today.¹³ China’s cities absorb between 10 and 13 million workers from rural areas each year, exacerbating stress on infrastructure. Even those migrant workers fortunate enough to find employment often face insecurity, lacking access to education, health care, and social insurance, although the reform and likely demise of the *hukou* (household registration) system are starting to address these problems. Finally, China will need to take the plunge on financial and currency liberalization sooner or later, despite fears of repeating Japan’s miserable experience of the 1990s.

ADJUSTING TO CHINA’S RISE

As China’s rise ripples to the farthest reaches of the planet, a diverse set of adjustments is underway. The consequences are highly differentiated, depending on the existing mix of goods and services in a particular economy and its flexibility.

China’s massive appetite for raw materials – now accounting for between a fifth and a third of the world’s consumption of alumina, iron ore, zinc, copper and stainless steel – has boosted com-

modity prices and improved export earnings for countries as diverse as Australia, Brazil, and Angola. Nonetheless, in some of the exporting countries, the boom years are accompanied by concerns that China's resource demands and manufacturing prowess may frustrate their attempts at export diversification.

In energy markets, China was responsible for one third of incremental global demand in 2004, and is projected to account for 20 percent of incremental demand over the next quarter century.¹⁴ A Council on Foreign Relations (CFR) task force on Africa concluded that China's voracious drive to lock up supplies of oil and gas is putting Africa back on the strategic map: "All across Africa today, China is acquiring control of natural resource assets, outbidding Western contractors on major infrastructure projects, and providing soft loans and other incentives to bolster its competitive advantage."¹⁵ While there are concerns in Europe and the United States that Chinese investors may undercut internationally agreed investment, export credit, and anti-corruption standards, African suppliers generally welcome the increased competition.

**The most extensive adjustments
have been in China's
immediate neighborhood.**

Another group of countries has not fared as well. Producers of labor-intensive consumer goods and other manufactures, confronting a formidable lower-wage competitor, have few choices: cut costs or move up the value chain. Thus, in far-flung Latin America, China's rise is creating export opportunities for resource-rich Brazil, while Mexican manufacturing exports are suffering in head-to-head competition with lower-wage China.¹⁶

The most extensive adjustments, however, have been in China's immediate neighborhood. The mid 1990s witnessed an active debate on whether China would follow the flying geese model of Asian export-led growth oriented to the U.S. market – tucking itself between Malaysia and Vietnam as the formation upgrades its industrial performance. Others predicted a scenario more like fighting cocks than flying geese, with China vying with other low-wage economies in the region for labor-intensive export markets. Indeed, China retains a wage advantage in the region against all but the poorest Association of Southeast Asian Nations (ASEAN) members. Even after controlling for the productivity advantages of many of its neighbors, where China is narrowing the gap, China's costs of labor per unit of manufacturing output (economists' favored measure of competitiveness) are below those in Indonesia, Malaysia, Philippines, Thailand, and Singapore.¹⁷

While China's entry may indeed have been dominated by trade competition in the mid 1990s, the past several years have witnessed growing integration within the regional economy.¹⁸ As a result, China's growth appears to be a boon for high-income Asian suppliers of capital goods and intermediates such as Japan, Singapore, and South Korea. China is now the first or second largest export market for Japan, South Korea, and Singapore, and runs trade deficits with those countries. Middle-income countries with diversified export sectors, such as Malaysia, Thailand, and the Philippines, have also benefited.¹⁹ However, low-income countries such as Bangladesh, Cambodia, Sri Lanka, and Pakistan are suffering displacement by Chinese exports without commensurate expansion of export opportunities into China.

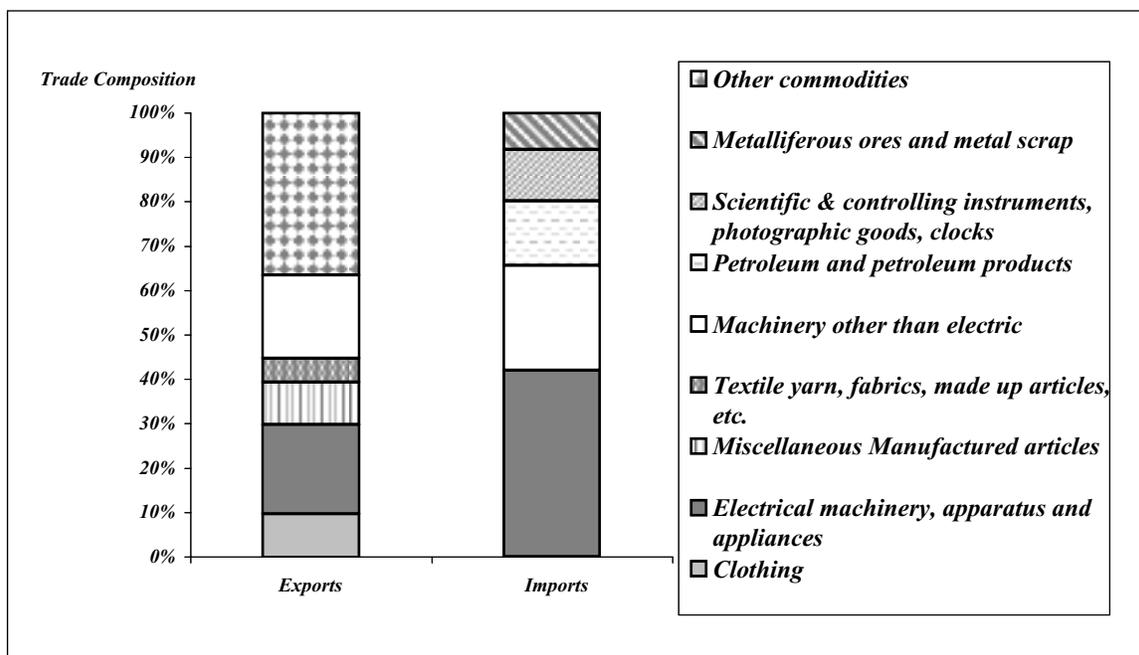
China's sponge-like absorption of FDI flows, especially from countries in the region such as Singapore and Japan, has set off concerns about hollowing out and deindustrialization in the region. Prior to 2001, it appeared that many of the investment flows in the region were comple-

mentary – expanding production networks across the region, with processing and assembly operations concentrated in China.²⁰ In contrast, more recent evidence suggests that after China’s WTO accession improved the security of China’s foreign market, FDI into China was more likely to be a substitute for direct investment into ASEAN markets. This is seen in the fall in FDI into ASEAN after 2001 and the ballooning of FDI into China in the same period.²¹

As countries contemplate their future position in global supply chains, there is substantial apprehension concerning the perceived speed with which China is moving up the value chain – using foreign investment to leapfrog to higher value sectors rather than progressing linearly. Stories of Chinese inducements to establish domestic research and development (R&D) facilities, combined with rapid shifts in the composition of China’s exports, are raising concerns that China could ultimately beat the United States and other advanced economies in their most sophisticated products.

China’s trade has indeed been shifting from the most labor-intensive manufactures of footwear, apparel, and lower end consumer goods to telecommunications equipment and office machinery. Many fear autos could be next. However, the trade statistics should be interpreted with some caution – since they mask considerable fragmentation of production. While China’s exports of final products are moving into higher value areas, Chinese workers are still predominantly undertaking the lower value downstream activities – with higher value production processes undertaken in more advanced economies. As shown in the comparison of the composition of China’s exports and imports in Figure III, below, China’s appetite for sophisticated capital and intermediate goods is expanding rapidly, reinforcing the picture of an integrated supply chain.

Figure III. China’s Imports and Exports in 2005



Source: UN Statistics Division, Commodity Trade Statistics Database, 2005

SURFING THE WAVE: THE REGIONAL RESPONSE

China's breathtaking export growth was already discernible in the 1990s. The big surprise has been the deftness with which China has handled adjustment pains in the region and the pragmatic determination of many of its closest neighbors to surf the wave rather than resist it. China itself has eased the adjustment through its smile diplomacy, settling regional territorial disputes, abjuring the use of force in Southeast Asia, and actively promoting and supporting regional fora. Growing regional integration and growing Sinocentrism have been driven mainly by developments in the region, but America's preoccupation elsewhere and seeming disengagement have played some role.²²

**The emerging economic realities
have been reinforced by a growing
network of regional political agree-
ments that place China at the center.**

Within less than a decade, Asia's trade and investment relations have reoriented towards China, with Japan and the United States exerting a weaker gravitational pull. The emerging economic realities have been validated and reinforced by a growing network of regional political agreements and arrangements that place China at the center.

At the heads of state level, a summit of China, South Korea, Japan, and ASEAN, has become an annual event, the so-called ASEAN Plus Three. For the first time last December, they were joined by India, Australia, and New Zealand in a grouping (the East Asia Summit) that resembles earlier attempts to form an Asian counterpart to the Asia-Pacific Economic Cooperation (APEC) without the United States.

These political associations are helping to solidify rapidly proliferating regional trade and monetary arrangements. Despite trepidation among many of its members, ASEAN has moved forward boldly to negotiate a free trade agreement with China that will come into effect by 2010 for the original ASEAN members, and more free trade agreements involving China are expected to emerge.²³ While critics dismiss these arrangements as shallow and lacking teeth, they miss the point that these political arrangements are evolving organically, reflecting and facilitating rapidly deepening commercial ties. They are thus likely to prove more significant in consolidating durable regional integration than the more demanding bilateral agreements the United States is concluding with distant and poorly integrated political partners such as Morocco and Bahrain.

In the monetary arena, there is considerable appetite for regional mechanisms to avert a repeat of the traumatic experience of 1997 and the humiliation associated with IMF lending conditions. Although the so-called Chiang Mai initiative has yielded only modest swap arrangements so far, growing regional trade integration and a shared aversion to exchange rate volatility provide fodder for talk of an Asian Exchange Rate Mechanism (ERM) modeled on Europe's precursor to the euro. While this in itself was predictable, the astonishing new twist is speculation that the yuan rather than the yen might become the anchor currency akin to the deutsche mark's role in Europe.²⁴ (This seems far fetched at present, given China's weak financial system and capital controls).

Chinese officials have also pursued relatively deft economic diplomacy in multilateral fora, winning over potential adversaries. Despite often having starkly different interests in the collapsed WTO Doha Round negotiations relative to developing country counterparts such as India, China

has operated as a core member of the G21 caucus opposing U.S. and European positions. In addition, despite its conspicuously undervalued exchange rate, China has managed to deflect criticism and avoid serious interference by the IMF.

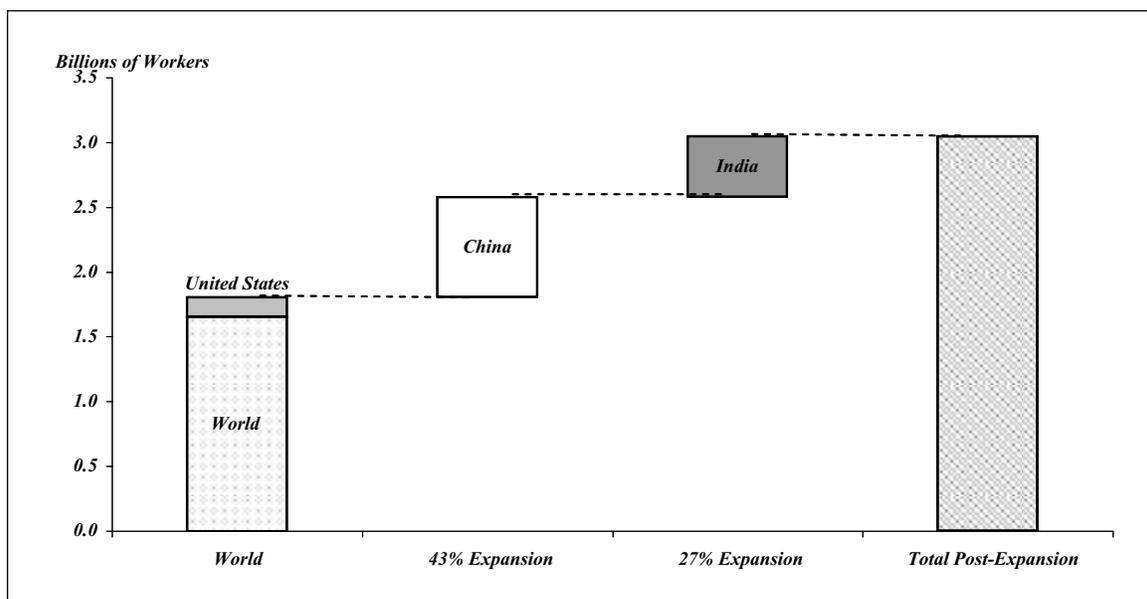
ENOUGH ABOUT THEM...

The United States' adjustment to China's newfound economic clout has been neither deft nor pragmatic. Feckless fulminations about China's unfair exchange rate and threats of retaliation have not been matched by an effective strategy to resolve significant bilateral tensions.

While U.S.-based multinationals race to establish a foothold in China's growing market, and U.S. consumers rush to stock up on merchandise bearing the "Made in China" label, American manufacturing workers, small business owners, and politicians evince palpable anxiety about the latest wave of globalization. Their concerns should not be dismissed lightly. While even Paul Samuelson has been quick to argue that the picture he painted of a low-wage country developing a comparative advantage across our previous export strongholds does not apply to today's reality, there are nonetheless important distributive consequences. These are likely to be particularly acute during the transition period before Chinese domestic demand rises sufficiently, exacerbated by currency misalignment.

The adjustment pains felt in the United States and other advanced economies reflect not just the integration of China into the international division of labor, but also the integration of low-wage India following quickly on the heels of the former Soviet bloc (along with technological progress that has made a variety of occupations newly vulnerable to automation and offshoring).²⁵ China's integration into the global labor market amounts to an expansion of 43 percent; adding India's concomitant integration implies an expansion of 70 percent over the course of 10 to 15 years, as shown in Figure IV, below.

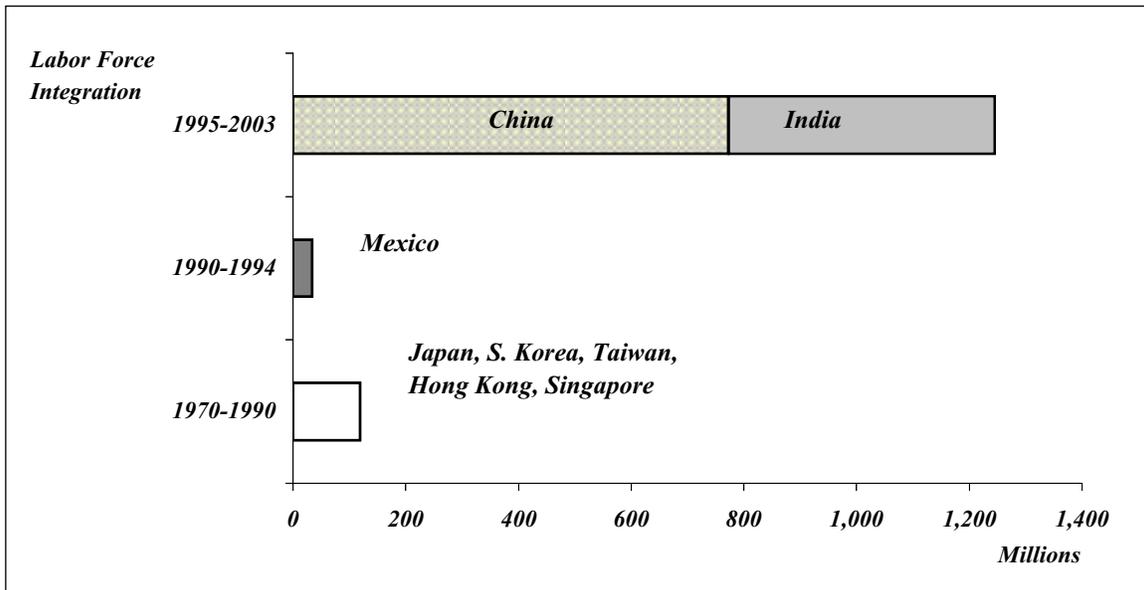
Figure IV. Integration of the Global Labor Force



Source: International Labor Organization (ILO) Statistics

Moreover, by most measures, the current episode of global labor market integration dwarfs previous episodes, as seen in Figure V.

Figure V. Episodes of Global Integration



Source: ILO Statistics

Wage rates in China and India are a small fraction of those prevailing in the advanced economies. The entry of 1.2 billion lower-wage workers into the global labor force thus puts downward pressure on the wages of similarly skilled workers elsewhere – while increasing profits and the earnings of other complementary inputs – at least for some initial adjustment period.

U.S. wage inequality has resumed growth, controlling for education and demographic differences. How much of the increase in inequality is associated with China's export growth as opposed to the decline of unions, immigration, and other factors? Earlier estimates suggested that less than 10 percent of the growth in inequality between high and low-skilled workers could be explained by increased trade prior to the mid 1990s. However, inequality patterns appear to have changed starting in the mid 1990s. The gap between the middle and top of the wage distribution (90-50 gap) appears to be widening, rather than the gap between the bottom and middle (50-10 gap), the locus of earlier concern. Researchers speculate that the role of trade and technology may be greater during the current episode, resulting in a squeeze in the middle.²⁶ In addition, China's growth could be making itself felt through indirect channels. Workers shed by Mexican maquiladoras squeezed by competition from China may well be adding to immigration pressures, just as growing competition from imports and offshoring contribute indirectly to the decline of unions.

A successful response requires a national strategy that invests in key areas of American competitiveness that have been neglected in recent years, such as science and technology infrastructure, including education and innovation, workforce training and adjustment, reduced reliance on a costly system of employer based health care, and restoration of fiscal probity.

In addition, there are a few areas of intense friction where engaging Chinese political and business leaders more effectively is critical. In the short term, the distortions associated with China's undervalued exchange rate present difficulties not only for global adjustment, but also for China's own macroeconomic management. There might be considerable disagreement on how to affect

We need a national strategy that invests in key areas of American competitiveness that have been neglected in recent years.

such a change and on the degree of misalignment.²⁷ This should not obscure the strong case for a significant appreciation of the yuan accompanied by further currency adjustment in the region, a credible plan for fiscal improvement in the United States, as well as stimulus in Europe and Japan. The United States could use coordinat-

ed multilateral pressure through the IMF and the G7 far more effectively than it has so far done. However, it must match demands for Chinese actions with fiscal commitments of its own, as in previous episodes of coordination in 1985 and 1993.

If it is to retain a leading position in the world economy and sustain its high standard of living, the United States must continue to advance the frontiers of innovation. For that reason, China's rampant intellectual property violations should be a concern to policy makers no less than to corporate executives, who too often feel squeezed between the need to establish a foothold in China's market and the near certainty that key process or product technologies will be vulnerable to imitation or theft.

Despite China's robust WTO commitments on intellectual property, 41 percent of businesses surveyed by the American Chamber of Commerce reported that counterfeits of their products in China increased in 2005. According to the Department of Homeland Security, China accounts for nearly 70 percent of border seizures of intellectual property infringing products – more than 10 times greater than any other country. The International Intellectual Property Alliance (IIPA) estimates that pirated copies account for 90 percent of China's market for business and entertainment software, music and movies. The problem is likely to worsen as growing internet usage in China creates opportunities for online piracy.

Inadequate intellectual property protection stems in part from weaknesses in Chinese laws and regulations, but the greatest problems involve implementation and enforcement, particularly criminal enforcement. Commitment on the part of the central government is not alone sufficient; it must be matched by better enforcement on the part of provincial and municipal governments, and the commitment of greater police resources.

Ultimately, Chinese business leaders and official authorities will have to view the protection of intellectual property as vital to China's own development in order to gain their proactive engagement. There are signs that such a transformation is under way at the highest levels, as evidenced by President Hu Jintao's recent statements. As policy makers seek to steer a high-tech future for China, ramping up support for national research institutes, research-oriented universities, and large national enterprises through such initiatives as the Hundred, Thousand and Ten Thousands Plan, the 985 Program, and the 211 Plan, they will increasingly appreciate the role of robust intellectual property protection for capturing returns to Chinese innovation investments.²⁸

However, this transformation may be excessively slow and costly for U.S. innovators. To address the immediate problem, American policy makers will need to employ a multi-pronged approach, combining engagement and technical assistance with the selective use of dispute resolution mechanisms to enforce rights. After all, securing such enforcement rights was the purpose of the hard fought efforts to include them in China's WTO agreement.

U.S. advancement of these individual goals would be far more effective – and the evolution of the bilateral economic relationship far steadier – if the United States simultaneously pursued a concerted economic diplomacy strategy with the objective of shaping structures and arrangements to handle China's rise. The United States needs to get back into the game in Asia, before arrangements that exclude the United States predominate. It should be wooing natural allies in the region with parallel interests, rather than abandoning the field to China's charm offensive, as it has effectively done in the past four years. The United States has neglected APEC's economic agenda, with the result that regional policy makers have learned to bypass it in favor of Asia-only fora. The United States is devoting its energies to negotiating bilateral free trade agreements with selected members of ASEAN, while neglecting the ASEAN Plus Three approaches that are increasingly dominating the region's economic architecture.

**The United States needs to get
back into the game in Asia.**

The United States has a unique ability to shape global and multilateral structures to better reflect current realities. In energy, as the world's largest oil consumer, the United States has similar interests to those of the second largest consumer, China. As highlighted by Senator Lugar, the United States should actively seek to incorporate China into arrangements designed to manage global supply disruptions, such as the coordinated release of strategic petroleum reserves through the International Energy Agency (IEA).

Within the IMF, the United States could take a leadership role, brokering expanded "chairs and shares" for China and Asia commensurate with their economic heft – in return for a more muscular surveillance capacity that might lead to meaningful currency realignment. The United States should be leading a campaign to reinvent the G8 – recognizing that the current membership is inadequate for addressing today's global imbalances. And bilaterally, a high-level multi-agency mechanism should be elaborated to ensure sustained engagement across a range of issues rather than the episodic transactional encounters that currently dominate.

CONCLUSION

China's rise is a seismic event in economic terms. The United States has an enormous stake in shaping China's evolution through bilateral, regional, and global institutions and arrangements. Those in business and government who view China's growth as a benign development have erred in the last few years in advocating a hands-off approach. They are instead finding their hands tied as the domestic political discourse deteriorates. Both those convinced of the ultimate benefits and those disturbed by the distributive consequences and perceptions of foul play, have an interest in proactively undertaking sustained economic diplomacy to woo countries with common interests in revamping the bilateral, regional, and global architecture to shape China's rise. In parallel, and again working with foreign partners where possible, the United States should deploy the tools

afforded by the WTO and the IMF to demand action in areas of genuine economic friction, seeking solutions that are carefully tailored to China's circumstances.

The lessons of the 20th century provides ample reason to fear the rise of new powers (Japan, Germany, the Soviet Union), but also powerful grounds for optimism (the United States). Confronted with the ultimate need to *make way* for China's rise, establishing mechanisms and structures that encourage a *makeover* may be the best bet to tip the odds favorably.

ENDNOTES

- 1 I am grateful to Wing Thyee Woo for helpful comments and to Sarah Cannon for outstanding research assistance.
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Energy, The Environment,
and Other Transnational
Challenges

DAY II

CHINA'S ENERGY CHALLENGE

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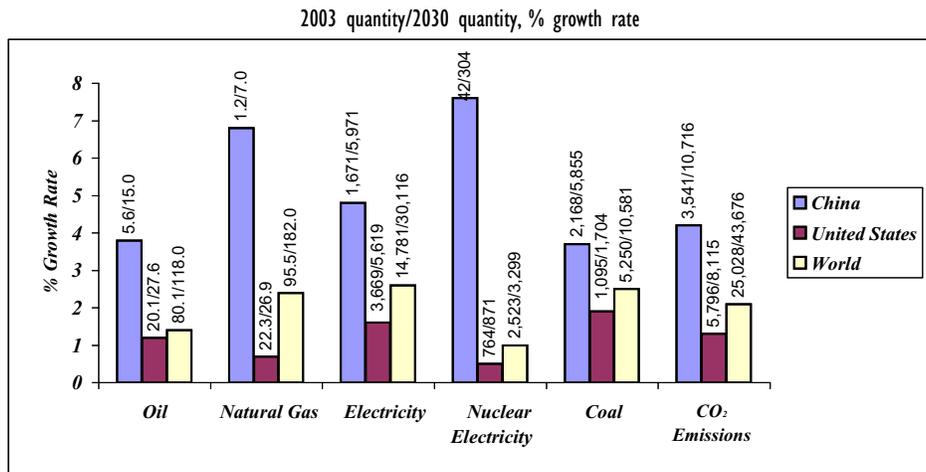


China's remarkable economic growth over the past two decades has enabled it to achieve social progress, has strengthened its geopolitical position, and has served as the lynchpin of the leadership's domestic political strategy. For the foreseeable future, China's leaders will continue to make economic growth a top priority.

As expected, this economic expansion has been accompanied by a corresponding surge in energy consumption. China became a net importer of oil in 1993, and it is now the world's third largest importer and second largest consumer. China has thus far been able to meet this increase in demand and prevent the economic slowdown that an energy shortage would precipitate.

However, the supply challenge is going to become greater for China in the years to come. We should anticipate that over the next few decades China's energy demand will grow between three and four times faster than that of the United States, as reflected in Figures I and II, below.

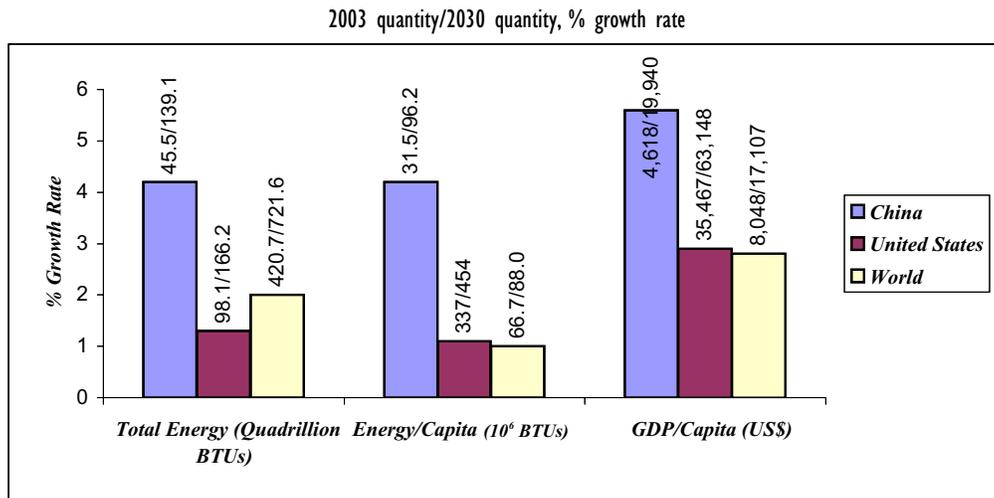
Figure I. Selected Energy Projections: China, the United States, and the World



Note: Units are as follows: million barrels/day (oil); trillion cu feet (natural gas); billion kWh (electricity); billion kWh (nuclear electricity); million short tons (coal); 106 metric tons (CO₂ emissions).

Source: Energy Information Administration (EIA) International Energy Outlook 2006, reference case projection

Figure II. Per Capita GDP & Energy Projections: China, the United States, and the World



Source: Energy Information Administration (EIA) International Energy Outlook 2006, reference case projection

CHINA'S ENERGY SECURITY CHALLENGES

The enormous projected growth in energy demand presents the Chinese government with at least three significant security challenges.

First, China will need to access international markets for ever more significant quantities of oil and natural gas. To date, China has sought whenever possible to avoid direct competition on the open market with the major international oil companies by arranging concessions in Iran, Sudan, and other countries where sanctions or other conditions limit or preclude open competition. China receives about 11 percent of its oil supply from Iran (which amounts to approximately a quarter of its total supply from the Middle East) and 5 percent of its supply from Sudan. China also relies on long-term, state-to-state contracts with major suppliers that include many non-market elements. In these arrangements, China is willing to pay a premium in order to lock up supply and avoid the international markets. It remains to be seen how its strategy will change as its energy needs grow.

Second, China must confront the security risks associated with the expansion of its nuclear sector. China's commercial nuclear power infrastructure is poised to grow by a factor of 7.5 between 2003 and 2030. Although its proven uranium reserves might be sufficient to meet this level of growth, China is in any event having little difficulty finding additional suppliers. It recently signed one such supply agreement with Australia. However, the risk of a nuclear power plant accident in the course of this expansion must not be overlooked. A serious, Chernobyl-scale accident would set back China's nuclear development and halt the growth of nuclear power worldwide. The non-proliferation threat, meanwhile, is now relatively small, as China has steadily committed itself to meeting the obligations of non-proliferation treaties and norms since the early 1990s.

Third, China is projected to emit ever-increasing quantities of carbon dioxide, sulfur dioxide, and other pollutants because of both its reliance on traditional coal power plants for electricity production and the growing demand for oil in its booming transportation sector.

At present, coal comprises approximately 65 percent of China's primary energy consumption, and it will continue to figure prominently in China's energy mix for years to come – perhaps even more so than is currently anticipated. The reason is simple: China has vast coal reserves and coal is cheap (about \$1 per MMBTU) compared to imported natural gas (about \$6 to \$7 per MMBTU at today's world price). Nuclear power, even with its massive expansion, is projected to provide only slightly more than 10 percent of Chinese electricity in 2030, while the projected growth of natural gas consumption – close to a six-fold increase in this same time period – is optimistic. The remainder of electricity demand, in addition to any shortfall on the nuclear or natural gas supply side, will largely be met by coal power plants.

Meanwhile, the rapid increase in the number of vehicles in China is contributing significantly to a rise in carbon emissions, and the situation is only going to get worse. The number of vehicles in China – already the world's third largest car market – is expected to increase six-fold or more by 2020.

GREEN CHINA?

The health and environmental threats posed by China's emissions are not purely domestic concerns. Clouds of sulfur and other pollutants from China's coal power plants are drifting offshore and affecting China's neighbors, and the impact of its carbon emissions on global warming is growing more severe each week. In 2005, China built about 75 large coal power plants, each of which emits about 15,000 metric tons of CO₂ each day.

Clouds of sulphur and other pollutants from China's coal power plants are now drifting offshore.

China's central government has demonstrated a growing awareness of the environmental burdens that accompany its current and projected pattern of energy use. Its latest five-year plan makes clear its intention to improve environmental quality, although just how far it is willing to go – and how much it is willing to pay – remains to be seen.

There are some areas in which progress is already underway. For instance, China has adopted measures to improve air quality in its cities by switching to natural gas and putting pollution control devices on coal power plants to control SO_x, NO_x, and particulate emissions.

China also has taken some steps to increase the efficiency of its automobile fleet. It has announced a tax of up to 20 percent for cars with poor gas mileage and emissions standards. This measure could help to ameliorate the rapid increase of urban pollution and, to a lesser extent, reduce oil demand in the transportation sector.

It is far less certain that China will move to market-based energy pricing, adopt demand-side management practices, moderate the growth of cars for personal use (rather than simply mandate greater vehicle efficiency), or pay the added cost of controlling carbon emissions from its coal plants.

One challenge that the central government faces is how to reconcile its need to control energy growth with local imperatives to maintain economic growth. The five-year plan has identified improved energy intensity as a preferred route, and there is ample room for progress in this area. China is far less energy efficient than either industrialized countries or some rapidly emerging ones (e.g., India). However, it is not making adequate investments – or using adequate technology – to

meet its goal of quadrupling GDP while only doubling energy consumption by 2020. Moreover, decision-making in the energy sector is decidedly a regional and provincial matter in China because it is the local authorities that have the responsibility to fuel the engine of economic growth. Tip O'Neill would remind us that in such a situation, the pace of change at the local level and the implementation of centrally mandated regulations are likely to be slow.

The least likely development is that China will choose to pay for the higher capital cost of electric power alternatives associated with carbon capture and sequestration. Consequently, carbon emissions will not be meaningfully constrained – and global warming will not be successfully combated – without some kind of international involvement in China's electric power sector.

GUIDING PRINCIPLES FOR U.S. POLICY TOWARD CHINA'S ENERGY GROWTH

The general principles that should guide U.S. policy are as follows.

- Energy security is just one interest – albeit an important one – that the United States must manage in its relationship with China. Other issues loom large (e.g., Taiwan, North Korea, human rights, trade, and intellectual property rights) and none of them can be considered wholly independently of one another.
- The United States must recognize that China has its own set of regional concerns and challenges involving energy. This manifests itself as acute energy and political competition with Japan (including a volatile dispute over oil and gas drilling rights in the East China Sea) and deepening energy ties with Russia (which is a serious source of concern in Europe, where Russia's long-term reliability as a major natural gas supplier is now in doubt).
- The United States has limited leverage on China to encourage modification of its energy policies. Proposals to use trade or investment restrictions (e.g., Export-Import Bank or World Bank-tied loans) to attempt to compel China to revise its energy policies are unrealistic and unlikely to be effective, particularly because China has no immediate capital needs.
- The United States must identify and explore mechanisms that go beyond the good intentions of “engagement and consultation.” The Bush administration's “responsible stakeholder” policy toward China is firmly rooted in this level of engagement, and its limitations are increasingly apparent.
- U.S. expectations should be based on what is feasible given China's internal politics and bureaucratic structure and the United States' own energy policy. To this end, the United States needs to develop an evolving model of energy decision-making in China in order to determine whether at a given point in time China is trending toward (1) a centrally controlled economy, (2) a competitive market-oriented economy, or (3) a highly decentralized economy with local actors making arrangements that meet local needs (e.g., local managers of a Chinese coal power plant will be told to add scrubbers to reduce sulfur emissions, but they will not be permitted to increase the price of electricity to cover the added cost of generation).
- The United States is seeking opportunities for constructive engagement on energy issues with other rapidly emerging economies – such as India, Indonesia, Mexico, and Brazil – but the political relationship with these nations is much less demanding than it is with China.

- The United States' own energy posture influences that of China. The response of the United States to the China National Offshore Oil Company's (CNOOC) bid for Union Oil Company of California (UNOCAL), for instance, helped to shape China's perception of the reliability of international oil markets. Similarly, the United States' lack of an aggressive domestic strategy for limiting carbon emissions influences China's approach to the issue of climate change.

U.S. POLICY OPTIONS

It is with these general principles in mind that we turn to the specific trends, challenges, and opportunities presented by China's energy policies in three key areas: oil and natural gas, nuclear energy, and carbon emissions from coal-fired power plants.

The Oil and Natural Gas Sector

Since 2004, there has been a dramatic increase in China's interest in gaining access to international oil and gas reserves. This would be unexceptionable if China were relying on transparent arrangements arrived at on market terms. If it chooses to overpay or take exceptional financial risk, so be it.

The problem from the perspective of the United States, however, is that China is increasingly entering into state-to-state arrangements with major resource holders that include significant non-market aspects, e.g., building airports, offering credit, tying foreign assistance to energy investment, and associating engineering and construction projects with energy supply deals. The states with which they have made such arrangements include Angola, Sudan, Iran, Algeria, and Saudi Arabia.

The net result of these non-market transactions is this: China is building political relationships that constrain the ability of the United States to pursue its interests in the Persian Gulf or with other major resource holders.¹

One such relationship that the United States must pay special attention to is that between Russia (a major resource holder that uses energy to gain political leverage) and China (a major oil and natural gas importer interested in locking up supply). As their energy relations warm, so too will their political relations, and it is patently not in the strategic interest of the United States for these two countries to become closely aligned. For instance, their joint membership in the Shanghai Cooperation Organization (SCO) – a regional security group that also includes Kazakhstan, Uzbekistan, Tajikistan, and Kyrgyzstan – has already allowed them to increase their influence in Central Asia at the expense of the United States and other consuming countries. This could have significant energy security implications, as Central Asia serves as an important supplier of (and transit route for) oil and natural gas. Some observers believe that it was through the SCO that Russia and China successfully pressed for the eviction of U.S. forces from Uzbekistan in 2005.

China is increasingly entering into state-to-state arrangements with major resource holders that include significant non-market aspects.

China is far from the only Asian country in need of Russia's resources. The west-to-east transfer of oil and natural gas from Russia and Central Asia will need to be allocated between China, Japan, and other major consumers (such as South Korea, Taiwan, Thailand, and Vietnam). There will be fierce competition for these resources, and this competition will give Russia special opportunity to gain influence in the region. Russia has already proven adept at playing China and Japan off one another in the course of negotiations over the route of a proposed oil pipeline from Siberia.

In spite of the challenges, engagement with China on some oil and gas issues is important. To this end, the United States should lead efforts to do the following.

- Bring China into the International Energy Agency (IEA), either as a full member or as an informal partner. The IEA, an oil consumer group that among other things coordinates emergency responses in the event of supply disruption, cannot function effectively or efficiently when a major consumer like China is not a participant. Other large, rapidly growing emerging economies that are dependent on imported oil and gas, like India, should be included as well.
- Encourage China to acquire adequate national and industrial reserve stocks of crude oil and oil products. As an IEA member, China would be required to maintain strategic petroleum reserves equal to 90 days of net imports.
- Work with China to explain the advantages of open and transparent international oil and gas markets. China is distrustful because of the U.S. dominance of these markets, and CNOOC's thwarted bid for UNOCAL only served to reinforce this distrust.
- Establish transparent rules and regulations for foreign investment in and acquisition of U.S. energy assets. It is important that U.S. domestic political factors do not needlessly interfere with a fair and open international market, as was the case with CNOOC's failed bid for UNOCAL.
- Cooperate on energy infrastructure security issues. This includes developing a common understanding about naval operations to protect key sea lines of communication, the protection of key energy facilities (such as liquefied natural gas (LNG) terminals), and the use of Supervisory Control and Data Acquisition (SCADA) information security.
- Promote open access to pipelines in Central Asia (west-to-east and north-to-south) and expanded access to Russia's pipelines.
- Create an international biofuels market to reduce oil competition and provide new sources of energy outside of the Middle East. The United States can promote the development of an international alternative fuel markets by rapidly expanding its domestic demand for biofuels (e.g., mandating that all cars be flex-fuel vehicles that can run on high blends of ethanol or other liquid fuels derived from biomass) and phasing out the existing tariff on imported ethanol. China, which is unlikely to replace a significant amount of its food crops with energy crops, would be able to benefit from such an international market. Japan has already begun moving in this direction by importing ethanol from Brazil.

The Nuclear Energy Sector

China is a nuclear weapons state that possesses all of the elements required for nuclear power. China's ambitious goal for deploying nuclear power presents no direct security concern to the United States. However, there are some indirect effects that are potentially troubling.

- Should China decide to export nuclear fuel cycle technology – enrichment or reprocessing – to other countries, this would undermine our vital non-proliferation interests.
- Should China transfer commercial nuclear technology as part of its package of inducements in an energy deal with countries such as Algeria, Iran, or Saudi Arabia, this would pose a lesser but still significant proliferation threat.
- Should China in its rush to deploy power plants experience an accident, it would have a disastrous effect on the revitalization of commercial nuclear power throughout the world. This would undermine the global interest in assuring every country has access to safe nuclear power.

Carbon Emissions

In the mid term, managing the size of China's carbon emissions is the most important issue that the United States will face. If China and the other large, rapidly emerging economies do not control their carbon emissions, catastrophic global warming simply cannot be avoided – regardless of what steps are taken in Europe and the United States.

At the heart of the difficulty in reaching an agreement on emissions between developed countries (which have already emitted vast amounts of CO₂) and emerging countries (which are projected to emit vast amounts of CO₂) is the issue of equity. In other words, "Who pays?"

The United States can engage China on any of three levels.

- Promote involvement in the context of ongoing deliberations of the international climate change process. A first step would be for China to commit to meeting an energy intensity target. There exists within China a certain degree of pressure to make this type of "great nation" commitment, but little has come of it to date.
- Encourage clean energy technology transfers to China, as well as the construction of demonstration projects bearing on energy efficiency and carbon control. For instance, the United States could initiate carbon sequestration projects in China.²
- Transfer payments to cover all or a portion of the costs of carbon control in China for some period of time. CO₂ capture and sequestration costs about \$30 per ton of captured CO₂. Thus, it would cost some \$30 billion to prevent each gigaton of CO₂ emissions. China will be unwilling to pay the additional cost associated with carbon controlled energy production, which poses the question of whether the international community is willing and capable of paying for this difference.

In the mid term, managing the size of China's carbon emissions is the most important issue that the United States will face.

This last option is indeed the most direct and immediate solution to China's carbon emission problem, but it presents a serious, perhaps insurmountable, obstacle. While the international community might be willing to pay for a part of the cost of controlling China's emissions, this plan is feasible only if the United States and other large industrialized countries are willing to make an enormous, ongoing contribution. Given the relationship between the United States and China, it is difficult to imagine that a huge direct payment by the United States would be politically feasible. In addition, any U.S. financial assistance without conditions of some participation by U.S. industry and some degree of control over project selection and accountability is inconceivable. The possibility that the Chinese would accept such conditions is equally unlikely.

There is little chance of progress as long as the United States has no carbon control policy.

Indirect and less transparent payment mechanisms might enable the United States to circumvent the political obstacle. For instance, the United States could enter into an international cap-and-trade system in which U.S. businesses could purchase huge quantities of carbon credits from China. However, the magnitude of the transfer required might make it difficult to conceal the underlying economic cost to the United States. Moreover, devising a scheme that establishes a baseline from which carbon emission savings are measured is itself not easy.

Ultimately, if the United States fails to make significant progress with China on any of three levels outlined above, then the global warming timetable will be accelerated and the range of policy options for averting its impact will quickly narrow. It is time for the United States to develop serious policy options to respond to a scenario in which China's carbon emissions continue at the projected rates.

However, while the United States must continue to seek China's cooperation, there is little chance of progress as long as the United States has no carbon control policy. The International Energy Agency estimates that China will be the world's largest emitter of CO₂ by 2009, but it also projects that on a per capita basis the United States will emit far more than China does for years to come. The ability of the United States to take the lead in the international arena will be severely compromised if it remains unwilling to adopt aggressive carbon reduction policies itself.

ENDNOTES

- 1 Note that this was not a factor in the China National Offshore Oil Company's effort to acquire Union Oil of California. That effort was stymied by U.S. domestic political factors, not by market forces or legitimate national security concerns.
- 2 The European Union has agreed to provide China with technology and funding for a new carbon capture and sequestration coal plant.

DAY II

**PUBLIC HEALTH AND CHINA:
EMERGING DISEASE AND CHALLENGES TO HEALTH**

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Over the past 50 years, China has produced considerable gains in health. Life expectancy has essentially doubled, infant mortality has declined dramatically, and there have been notable reductions in the rates of many major infectious diseases.¹ To a significant degree, this progress was achieved through public health² measures such as health education, improved hygiene and sanitation, and immunization. Expanded access to personal health care services, especially preventive care, also made an important contribution. However, in recent years, a number of confluent factors have led to significant erosion of China's public health system, slowing China's progress in health and in some areas producing significant vulnerabilities and setbacks. The emergence of serious and far-reaching new public health concerns underscore the urgent need for China to address its deepening public health system problems. Failure to do so will surely have catastrophic health, economic, and political consequences for China's future. In the case of potential epidemics of infectious disease, whether Severe Acute Respiratory Syndrome (SARS), avian flu, HIV/AIDS or the next unknown, weaknesses in the public health capabilities of China could have devastating impacts around the globe.

This paper will examine some of the critical public health challenges facing China today, with special attention to the national and international threats posed by microbial disease. It will attempt to review the current status of the public health system, briefly examining how certain aspects of China's economic transition, such as "privatization," and the elimination of the collective system have inadvertently undermined important aspects of the public health system. With this as background, it will discuss some of the steps needed to strengthen the health system and its public health functions, programs, and institutions in order to more effectively prevent, control, and monitor threats to health. Given the transnational implications of adequate disease prevention, preparedness, and response capabilities, the roles and responsibilities of foreign governments and multilateral institutions will also be discussed.

PUBLIC HEALTH ORGANIZATION AND MANAGEMENT

Historical Perspective

Prior to 1949, China had no organized, publicly-financed health system for either the delivery of care or public health services. After the Chinese Communist Party took control, the government created a health system that was largely modeled after the Soviet approach. The government owned, funded and operated all hospitals and clinical facilities; physicians, other health care providers, and public health practitioners were predominantly funded by the state. Health care was provided through a tiered approach, with public health programs closely intertwined with the system for health care delivery. In rural areas, the cornerstone of health care was the Commune, which provided services through the Cooperative Medical System. At the grass-roots level, so-called “barefoot doctors” worked out of village health stations. Equipped with only very rudimentary training, they delivered both primary care and basic public health services, including immunization, hygiene education, and disease surveillance. In urban areas, the majority of these health services were provided by paramedical professionals assigned to factories or neighborhood health stations.³

China’s decision to move toward a market-based economy resulted in enormous disruptions in public health and health care finance and delivery.

From the beginning of the 1950s, a major emphasis was placed on disease prevention and public health. Additional public health capacity was created through the establishment of Anti-Epidemic Stations (later termed Epidemic Prevention Stations (EPS)) at the provincial level and in larger cities. The EPS were responsible for public health activities like disease surveillance, outbreak investigation

and control, and food hygiene and inspection, but they were not generally responsible for routine communicable disease control problems such as tuberculosis (TB) and sexually transmitted disease (STD), or for health education. Several disease specific institutes were also created to deal with special disease control needs such as for plague, leprosy, malaria, TB and schistosomiasis, along with The National Center for Preventive Medicine (now significantly expanded and restructured into the China Centre for Disease Control (CDC)).⁴ Schools of Public Health were established at medical universities to support training in public health as well as research. The Chinese population was mobilized to participate in mass “patriotic health campaigns.” Many of these were quite successful. For example, there was a major “away with all pests” campaign to reduce insect and rodent borne disease.⁵ Other major health campaigns were directed at improving water quality and appropriate human waste management.

Economic Reforms and the Impact on Public Health

Strikingly, the period from 1952 to 1982 was marked by impressive improvements in health. However, beginning in the mid 1980s, this apparently successful health care and public health system experienced a series of unexpected and serious shocks as the government entered a new period of economic reform. China’s decision to move toward a market-based economy, combined with a general effort to decrease the role of Beijing’s central government in China’s regional and local affairs, resulted in enormous disruptions in public health and health care finance and delivery. The

full extent of the damage is only now being fully recognized, but several important policy shifts clearly had devastating affects.⁶

Marked cutbacks in the central government's spending on health and the transfer of much responsibility for health services funding to the provincial and local levels led to the virtual privatization of hospitals and clinics. A shift to a fee-for-service model encouraged health practitioners to earn extra money from pharmaceuticals, tests and procedures, leading to rapidly increasing health care costs and spending, along with significant concerns about quality and appropriateness of care. Health care soon became almost unaffordable for many Chinese citizens. In addition, when the government abruptly dismantled the commune system, the safety net system throughout rural China was thrown into disarray. Without the Cooperative Medical System, an estimated 900 million rural and mostly poor Chinese lost routine access to health services.

Finally, China reduced spending and decentralized its public health system. Support for public health at the local level was deeply cut, resulting in substantial reductions in public health activities, especially in the poorest areas. Local public health authorities were given the opportunity to make up for lost revenues by delivering personal health services and charging for certain public health functions such as sanitary inspections. Unfortunately, this led public health agencies to concentrate on revenue-generating activities, neglecting vital, core public health functions such as health education, disease surveillance, and communicable disease control. Additionally, as the "barefoot doctors" were forced to become private practitioners, they abandoned the public health functions and preventive services for which they were not compensated.

Current Status of Public Health

Examination of public health in China today reveals a system struggling to cope with the consequences of China's economic reforms, as well as the accompanying pressures of urbanization, industrialization, environmental degradation, globalization, and an aging population. Once well developed and supported, China's public health programs have been badly damaged by the funding shortfalls and significant dislocations in operations, workforce, coordination, and oversight.

While this paper focuses on China's increasing vulnerability to infectious disease threats, it is important to at least recognize the huge and growing burden of chronic, non-communicable disease. The problems of an ailing public health or health care system are compounded by a set of disease risk factors such as aging, smoking, poor diet, inadequate exercise, and pollution. The World Health Organization (WHO) estimates that chronic diseases now account for about 79 percent of all deaths in China.⁷ Beyond the toll in disability, disease, and death, there are far-reaching economic, social, and political consequences, and the Chinese people are increasingly troubled by their government's inability to address their needs.⁸

Chronic diseases now account for about 79 percent of all deaths in China.

SARS Sounds the Alarm

There is a growing recognition of the importance of public health and the profound impact that a public health crisis can have, especially in the age of globalization. The 2003 outbreak of SARS was a wake-up call for China. Health authorities were caught unprepared and there were serious deficiencies in China's ability to mount an effective, coordinated response to this previously unrecog-

nized and potentially pandemic infectious disease. The situation was, of course, further exacerbated by the fact that health officials and government authorities were slow to acknowledge the extent of the emerging epidemic and failed to handle the growing crisis with the required transparency and openness of communication and information exchange. Critical time was lost in the identification

The impact of SARS on GDP in the region was between \$20 and \$25 billion.

of the infectious agent causing the epidemic and in the implementation of effective measures for control. As SARS spread rapidly from Guangdong province to other parts of the China, it quickly emerged elsewhere around the globe, including Vietnam, Singapore, Taiwan, and Canada.

China was forced to take stock of the situation. The Chinese government acknowledged the magnitude of the problem and indicated a clear commitment to improve public health. During the acute crisis of SARS, considerable political will was evident as the government moved to control the burgeoning epidemic following their initial sluggishness and denial. By launching a full force public health effort, including infusion of resources, public and professional education, establishment of new facilities, implementation of infection control measures, assurance of medical care, and enhanced cooperation and collaboration with the international public health and scientific community, China effectively brought SARS under control. Nonetheless, a high price was paid. Among other things, more than 8,000 people were infected (with some 800 deaths), cities were paralyzed for months, and a number of high-ranking officials lost their jobs⁹. The impact on GDP of countries in the region was estimated to lie between \$20 and \$25 billion.¹⁰

IS CHINA PREPARED FOR MICROBIAL THREATS?

The emergence of SARS in 2003 represented just one of many newly emerging, reemerging, or resurging infectious diseases that have declared themselves in recent years. Multiple factors contribute to this escalation of infectious diseases, including human demographics and behavior, shifts in land use, environmental degradation, urbanization, and international travel and trade.¹¹ Because microbes respect no borders, especially in today's highly interconnected and readily traversed "global village," one nation's problem can become every nation's problem.

New attention is focused on China's public health infrastructure and whether it will be appropriately robust for the task of detecting and responding to the looming threat of an avian flu pandemic or the next unrecognized microbial threat. Similar concerns surround China's ability to manage and contain other persistent infectious disease outbreaks, importantly including its growing HIV/AIDS epidemic. Clearly the SARS outbreak accelerated the development of public health programs and capabilities. Substantial new activities are underway, but will these efforts be both sufficient and sustained? Who is accountable for their success? And what are the roles and responsibilities of other nations and multilateral organizations to assure the ability of China to effectively respond?

Public Health Preparedness: What Is Required?

Effective disease prevention and public health preparedness is a dynamic enterprise that depends on the coordination and robustness of many diverse components. The chain of preparedness is only as strong as its weakest link. Critical elements of an effective program must include:

- Visible and sustained political will, including adequate commitment of financial and human resources.
- An effective surveillance or early warning system for rapid detection and response.
- A strong public health infrastructure supported with sustained funding and a well trained public health workforce.
- An accessible and competent health care system to support public health needs through diagnosis, disease reporting, and appropriate medical management and infection control.
- A comprehensive research agenda to improve the understanding of infectious disease threats and to develop new tools to address them.
- A multisectorial approach, with close coordination and open communication among agencies of government, levels of government, and with the private sector, including non-governmental organizations (NGOs), academia, industry, the media, and the public.

Across these various domains of activity, it is clear that China has certain strengths to build on, but it has only just begun the long march required to meet the public health challenges before them. Two different, but very real infectious disease threats, HIV/AIDS and the avian flu, pose immediate and long-term threats to China's domestic health, stability, and security. These examples are useful in assessing the ability of the Chinese nation to manage and control the spread of infectious disease, and can serve to illustrate the transnational nature of threats posed by issues of infectious diseases.

The Case of HIV/AIDS

China's painful experience with SARs revealed both the weaknesses in their public health system, as well as the social, economic, and political implications of a public health crisis. It pushed the Chinese government to respond to another epidemic of deadly, transmissible disease, HIV/AIDS, with the kind of urgency, candor, and commitment required to make a difference.

HIV/AIDS appeared in China in the mid-1980s, with significant spread first occurring in 1989 among injection drug users (IDUs). In the 1990s, a separate HIV/AIDS epidemic evolved from unsanitary black market blood collection practices. Risky sexual behavior has further contributed to the growth in disease, especially through China's sex workers.¹² As of the end of 2005, the Chinese Ministry of Health estimated that some 650,000 people in China were infected with an estimated 70,000 new cases every year. Among high risk groups, such as IDUs and commercial sex workers, the rates of new infection are quite startling.¹³ Several emerging risk factors suggest that there will be even greater increases in HIV infection – possibly even a breakout into the general population – due to the expansion of China's sex trade, decreases in the social taboos against pre-marital and extramarital sex, as well as greater tolerance of homosexuality. In addition, there is a growing “floating population” of migrant workers whose circumstances make them more likely to engage in risky behaviors for HIV such as unprotected sex and/or drug use. It is estimated that about 80 percent of those infected do not know they are HIV-positive, raising obvious concerns for the future spread of HIV, as well as barriers to effective treatment and care.¹⁴

The Joint United Nations Programme on HIV/AIDS (UNAIDS) has predicted that between 10 and 20 million people could become infected by 2010, and has termed the HIV epidemic as “China's titanic peril.”¹⁵ Unfortunately, the early days of the HIV/AIDS epidemic in China were

marked by official denial, secrecy, and blame. As the epidemic grew, Chinese response remained surprisingly passive, despite considerable pressure – both public and private – by international organizations, donor countries, and NGOs, who all sought to persuade the Chinese government of the economic and health costs of not acknowledging and addressing the epidemic head on. There were a few encouraging signs of action, yet it really seemed to take the disastrous experience of SARS – and the accompanying international scrutiny and shame – to galvanize the Chinese into the kind of leadership and action truly needed to combat HIV/AIDS.

Over the past few years, the response to HIV/AIDS across China has taken on a new intensity. The Chinese government has demonstrated a political will and commitment not previously in evidence. Top level leadership has now spoken publicly about what needs to be done, developing new policies, approving greater spending, and working with non-governmental agencies and outside groups, including the media. There is now a centralized AIDS office with sufficient clout to coordinate programs and provide leadership.¹⁶ Most recently, the government has begun to put in place an important new set of policies for comprehensive HIV/AIDS prevention and care, offering free HIV counseling and testing, as well as free antiretroviral therapy for those in financial need. Programs to provide assistance to the households of people living with HIV/AIDS and schooling for AIDS orphans have also been developed. HIV prevention programs such as condom education and distribution, methadone maintenance, and even needle exchange programs for IDUs are beginning to be implemented.¹⁷

Notably the Chinese government has shown far greater willingness to work with international organizations and to accept assistance, both financial and technical, from foreign governments and outside organizations. This new openness has enabled China to greatly expand its resource base. It has also enabled China to learn important lessons about what works and what doesn't from countries that are further along the epidemic trajectory. If implemented in a timely way, such insights may help to blunt the rising spread of infection and disease within its borders.

It remains to be seen how far and how fast HIV/AIDS will spread. Although it has expanded in both numbers and geographic distribution, the disease remains concentrated in certain marginalized populations. The impact of HIV/AIDS on the health of the general public and the corresponding pressures on economic productivity and social stability has not been experienced by China in the way that has so devastated countries in Sub-Saharan Africa and elsewhere. As the epidemic expands, issues of transmission across borders with adjacent nations have begun to emerge as a potential source of conflict and concern. The Chinese government has still not figured out how it is going to effectively provide HIV/AIDS related treatment and care, when it is already struggling to repair a badly damaged health care system and social safety net; nor are they entirely comfortable with confronting some of the cultural taboos and demands for openness about risk factors that effective HIV prevention programs truly require. Nonetheless, after years of denial, China finally has begun to come to terms with the reality of its HIV/AIDS epidemic, and seems prepared to address the implications at home, regionally, and internationally.

The Case of Avian Flu

As China attempts to strengthen its public health capabilities, the specter of a human avian flu pandemic looms as the overwhelming “worst-case” scenario. It is difficult to imagine a more troubling acute microbial threat to China than the next influenza pandemic. Avian flu truly does have the potential for rapid emergence and spread, which could sicken and claim human lives at levels

beyond anything experienced in our lifetimes, and swiftly undermine social, economic, and political stability within China and around the world. Unfortunately, most experts agree that the event of an influenza pandemic is not just likely, but it is inevitable and, in fact, overdue.

Over the past 300 hundred years, some 10 pandemics of influenza have been documented, with three occurring in the last century. The most famous pandemic was the so-called Spanish Flu of 1918-1919 which killed between 20 and 100 million people worldwide. Most consider this pandemic to be at the extreme end of likely severity for the next event. Yet this offers little comfort, since today, with some 6.5 billion people worldwide, even a “mild” pandemic could bring a death toll of millions.¹⁸

An influenza pandemic is not just likely, but it is inevitable and, in fact, overdue.

In recent years, an aggressive strain of influenza virus, H5N1, has been continuously circulating in avian species in many Asian countries, including China. This viral strain is lethal in chickens, ducks, and some wild fowl. As of July 20, 2006, the WHO confirmed 231 human cases to date, of which 133 have been fatal.¹⁹ In all but a few cases, the disease found in humans could be directly linked to contact with sick poultry or animals. Fortunately this viral strain has not developed the capacity to routinely be transmitted person-to-person. Should H5N1 modify in this way, there will almost certainly be a pandemic.

China sits in a particularly precarious position. In many ways it represents the ideal breeding ground for the creation of a pandemic strain of flu. In addition to the presence of H5N1 in bird populations, Chinese scientists have isolated H5N1 from nasal secretions of pigs, a species in which both avian and human influenza viruses can be harbored and replicate. Some scientists refer to pigs as a “mixing bowl” for pandemic strains, for they provide a convenient host in which an avian strain like H5N1 and a human flu virus strain can mix and “reassort” to yield a new virulent strain capable of human-to-human transmission. China has more people, pigs, and poultry (1.3 billion, 508 million, and 13 billion respectively) living in close proximity than any nation in the world – or in history.²⁰

Without a doubt, China, and the world, must respond as though the next pandemic is imminent. Certainly, the reforms begun after SARS will help to strengthen the infrastructure necessary for rapid pandemic detection and response. In September 2005, China announced that it had taken the additional step of developing a national influenza preparedness plan.²¹ The plan outlines the structure of the national preparedness system, as well as identifying critical goals, essential partners, and expected emergency responses. The Ministry of Health urged all localities to also draft their own plans.

Realistically, especially in the near term, it is unclear how much progress China can really make. It will be very difficult to correct the many long-standing deficiencies in the disease surveillance system, even with a major push. The challenges for the health care systems’ response are perhaps even more daunting. With limited technical capacity to develop and produce flu vaccine and drugs – not just in China but around the world – we know that there will be limited pharmaceutical tools to combat the disease outbreak. Moreover, the numbers of individuals requiring care and/or management will be very large indeed.

The prospect of a new pandemic influenza would be grim under any circumstances, but this would be the first such pandemic in the age of globalization. Disease spread would be dramatically enhanced by international travel and trade, but efforts to limit spread across borders through

restrictions on such movement would produce very variable results. Ironically, disease control measures could suffer as the result of failures of the international supply chains to provide basic products necessary for influenza prevention or care, such as face masks, respirators and medicines. More broadly, pandemic related dislocations of worldwide trade would send powerful ripple effects throughout industrialized and developing countries, testing resiliency in new and challenging ways.

The SARS epidemic presented the most severe social and political crisis to the Chinese leadership since Tiananmen.

The lessons from SARS, although a far smaller and more containable epidemic than we would anticipate with pandemic flu, demonstrate just how high the costs of an infectious disease outbreak can be. They underscore how poorly equipped governments are to cope with a serious or prolonged infectious disease crisis, and they remind us of the interconnections between health, social stability, and political leadership. One China scholar, Yanzhong Huang, suggests that the SARS epidemic produced the most severe social

and political crisis experienced by China's leadership since the Tiananmen Square crackdown in 1989.²² He concludes that the government's difficulties arose not so much from the public health impact of SARS, as from their withholding of information and failure to act.

Since that time, the Chinese government seems increasingly open about acknowledging the problems they have in the public health arena. Thankfully they have also demonstrated a far greater willingness to open their doors to help from others. A range of resources have proven valuable to China's efforts. Several nations and international organizations have mobilized to offer technical and scientific assistance, as well as to help fund programs at the local level for education, poultry vaccination, and compensation for farmers whose flocks must be culled. There have been a series of important international scientific collaborations to study the evolving H5N1 virus and to undertake sentinel surveillance of disease in domestic and migratory birds. The WHO recently established a formal Collaborating Centre for Surveillance, Research and Training on Emerging Infections in Guangdong Province. Epidemiologic and other public health training programs have been established in coordination with various foreign government public health agencies (notably the United States and the United Kingdom), the WHO, and also with certain foreign academic institutions (such as Columbia University and the Harvard School of Public Health). The WHO has partnered closely with the Chinese government to undertake investigations of human cases of H5N1 disease. Western philanthropies and NGOs have also played an increasing role in supporting efforts to strengthen disease surveillance and systems for response. At an earlier point, a number of World Bank programs were designed to help strengthen China's public health system's capacity for infectious disease prevention and control. However, due to its economic progress, China is no longer eligible for certain kinds of very low or no interest loans from the World Bank.²³

Strikingly, while continuing to be the recipient of international assistance, China's current position has led the government to reach out politically and financially to partners in the region, and to embark on a policy of being a donor as well. Of note, the Chinese government determined to give a donation of \$10 million to the Global Fund to Fight HIV/AIDS, Tuberculosis, and Malaria before becoming a recipient of its grants.²⁴ This past January, China demonstrated impressive leadership in hosting the Beijing Pledging Conference for Avian Influenza and making a \$10 million pledge.²⁵

OPPORTUNITIES FOR ACTION

It is heartening to see real interest by the Chinese government to improve public health capabilities within their nation. The global fight against microbial threats cannot succeed without China as a full and effective partner. Yet China's domestic capabilities remain of particular concern. Correspondingly, there are several important opportunities to strengthen international collaboration and foster U.S.-China cooperation and assistance. Several key areas demand additional focus and action.

Disease Surveillance and Early Warning

Following SARS, China has moved aggressively to strengthen its infectious disease surveillance system, which represents the frontline mechanism for rapid detection, investigation, and response to an emerging disease outbreak. At least on paper, the Chinese Infectious Disease Surveillance Network is impressive, with an extensive network of disease control centers at the national, provincial, and local levels. This system builds on the longstanding approach first initiated many decades earlier. In addition, the government has recently introduced an electronic disease reporting system that is based at the district level.²⁶ However, a series of operational issues must be addressed

Obtaining timely and accurate disease reports is a persistent problem, and actively seeking out that information is very labor intensive. The problem is worsened by inadequate training of frontline health workers to diagnose and report disease, as well as inadequate laboratory capacity for confirmed diagnosis. Furthermore, mechanisms for disease reporting are least well established below the district level. Since districts in China may represent hundreds of thousands of people, it is easy to imagine how a significant outbreak could emerge and take hold before it came to the attention of district authorities. Certain special populations or events present additional challenges. In particular, the mobility of people, including the vast urban migration, and the growing numbers of migrant workers or "floating" populations makes it difficult to always pick up important health information in a timely fashion.

As in many parts of the world, China still suffers a disconnect between systems for managing agricultural, wildlife, and human disease. Breakdown of these barriers is of special importance in China, which represents an unprecedented risk for zoonotic (animal to human) disease – a virtual laboratory for its emergence and transmission – with some 1.3 billion people living in close proximity to each other and to other animals, including domestic poultry, pigs, cattle, and wild game. It is not a coincidence that both SARS and avian flu – two serious recent zoonotic diseases – have emerged from provinces in China.

In addition, connectivity could be greatly enhanced by investments in information technology that would enable more timely communication of information as well the potential for enhanced data analysis. To fulfill its promise, electronic disease reporting must be extended below the district level.

Enhanced Transparency, Communication, and Coordination

In a society with traditions of strict government control and secrecy, information dissemination and sharing remains a major concern, both within China's national system and for the international community. In part, the problem stems from concerns about revealing potentially damaging information or reporting data for which they may be held accountable. In some instances it may have to do with "ownership" of data or materials for research or other purposes.

Whatever the cause, major and sustained efforts must be directed to the establishment of a more transparent, timely, accurate, and integrated system for public health management and coordination. There must be a reliable and expeditious mechanism to ensure that vital information for health gets communicated to all who need it, including health providers, government officials, international health organizations, the media and the public. This will ensure the necessary implementation of disease control measures in affected areas and alert others to look for similar symptoms or diseases. To avoid another catastrophic situation like SARS, China must ensure an effective system for early warning of disease outbreaks that is both timely and transparent, as well as greater sharing of diagnostic materials and samples for analysis.

Public Health Workforce

As China mobilizes to respond to the public health tasks ahead, inadequate attention and support for the public health workforce will surely impede progress. Currently, China has huge gaps in available workforce and far too few of China's existing public health workers and health care professionals are properly trained to diagnose and manage many of the conditions of public health concern. In addition, public health education aimed at preventing disease and controlling risks is sorely lacking. The Chinese government is increasingly aware of these critical needs and receptive to new strategies to rapidly train health workers, bolster their capacity, and augment their work with technical assistance. The international public health community, including the U.S. Centers for Disease Control and the WHO, has offered technical assistance and financial support to China in this regard. Several provinces have begun to develop their own training programs. This is a good start, but given the public health needs of the Chinese nation and its vast geography and population, an exceedingly large critical mass of public health professionals will be needed to rehabilitate the current disease surveillance and control system and rebuild public health capacity.

Health Care System

Although an extremely daunting task, China will remain ill-prepared to deal with the challenges of microbial threats without addressing the huge health care finance and delivery problems that have developed, largely as the result of economic reforms and "marketization." The set of possible needs and strategies for repairing their badly damaged health care system goes far beyond the scope of this paper. True overhaul is a long-term project, yet aspects of the current health care crisis are particularly detrimental to the nascent efforts to better prepare for microbial threats. These must be addressed as expeditiously as possible.

In the first place, health care systems – both public and private – play an essential role in the delivery of key public health services such as immunization, infection control, and communicable disease treatment or cure. In addition, reliable and well-trained health care practitioners are an essential element of the diagnostic and disease reporting system that underpins effective surveillance. Timely access to health care, regardless of an individual's location or ability to pay, is also vital for the early recognition of emerging problems and for mounting an effective response. Moreover, as witnessed during SARS, a hospital's capacity can quickly be overwhelmed when there is a surge in patient demand, especially when there may be an additional set of very difficult infection control requirements. Many hospitals in China lack the personnel, equipment and financial resources to effectively mobilize in response to a serious microbial threat to health. In addition, past outbreaks warn that without adequate capacities and effective strategies in place, health care facilities can actually contribute to the problem, serving as vectors for transmission of disease and

compromising the health and safety of an already badly stretched health care workforce. China's leadership must take on the difficult task of developing real-world plans for how they will cope with a sudden surge of patients, complete with explicit strategies for how to support mass medical care and other disease control measures.

Research Agenda

Given its many vulnerabilities to microbial threats, the Chinese government would be well advised to make infectious disease R&D a top priority in its national research agenda. Academic institutions, government research entities, and the pharmaceutical industry all must be engaged to address critical gaps in R&D. A particularly high priority should be the vital need for new vaccine strategies and development capacities, including for influenza.²⁷ Other types of research are also needed. For example, especially in light of SARS and avian flu, animal husbandry research could provide valuable insights into how to modify agriculture, food handling procedures, and animal storage and marketing practices, so as to reduce the likelihood of zoonotic disease. Greater interdisciplinary and international scientific collaboration in these areas would be beneficial to all.

The overall health and security of our nation – and the world – will depend on China's public health performance.

International Collaboration and U.S.-China Cooperation

Both China and the international community have a common interest in scaling up cooperation and assistance programs designed to improve China's public health and disease control capabilities. Virtually all of the public health and scientific challenges described above would benefit from greater investment and involvement by international partners. Certainly, a number of effective activities are underway, but the enormous fragmentation of effort can be seen in the patchwork of programs and services now being provided.

In recent years, the U.S. government has appropriately defined several key areas for health cooperation with China, including work on emerging and re-emerging infectious diseases such as influenza and SARS, HIV/AIDS, TB, and others. Efforts include financial support and technical assistance to upgrade surveillance and epidemiology in China, collaborative biomedical research, and opportunities for training and exchange of scientists, and medical and public health professionals. While potentially worthwhile, the efforts to date have been quite modest in scale. Expanding successful efforts will be a necessary next step. Activities must also be coordinated into a larger, more comprehensive framework for action to ensure effective use of resources and full partnership among the many Chinese and international players.

In addition, we must think more broadly about the value of such efforts. Collaborations of this kind not only strengthen scientific knowledge and public health practice, but they build confidence, transparency and promote new trust. The United States has a chance – through intensified government, NGO, and private sector action – to offer much needed knowledge, expertise, and technologies to help strengthen China's domestic capabilities for public health surveillance and disease control. In doing so, we may also help to foster positive social, economic, and political development in China.²⁸ In the final analysis, the overall health and security of our nation – and the world – will depend on China's success.

CONCLUSION

Few can doubt China's ability to mobilize for action when it sets an important goal. China's rapid rise from near universal poverty to an increasingly prosperous and powerful nation in little more than a generation has been astounding. Yet the economic reforms accompanying this rapid rise have left China's health systems in woeful disarray. In the context of a growing series of visible and significant public health concerns involving China, including HIV/AIDS, SARS, and avian flu, the Chinese government can no longer ignore or deny just how seriously their public health systems have been compromised. A new commitment to reform public health has been made, but there is yet no comprehensive plan and it remains uncertain whether the Chinese government is truly prepared to offer the financial and human capital necessary to realize this pledge.

Success will require sustained commitment, political will, and leadership. Aggressive efforts must be undertaken for the systematic reform of the organization, and the financing and delivery of health programs. This includes an urgent need to strengthen the public health infrastructure for disease surveillance and monitoring, provision of essential public health services, and public health education. Multisectorial efforts must be undertaken to improve coordination, planning, and support. With respect to China's deepening transnational public health problems, the Chinese government has a special obligation to act. Moreover, a new imperative for openness and international cooperation must inform all of China's policies and programs. Correspondingly, we have an obligation to assist China's efforts to bolster their public health infrastructure and systems for disease control. In our rapidly transforming world, China's contribution to the political, economic, and physical security and health of people everywhere cannot be underestimated. It is in our vital interest that China meets the health challenges of this new era.

ENDNOTES

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Of Soft Power and
China's Peaceful Rise

DAY III

POPULAR CULTURE IN CHINA TODAY

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In May 2006, *New Weekly*, a glossy, influential Beijing magazine known for spotting new urban cultural trends, ran a feature on the packaging and selling of Chinese culture. Among the several prominent figures in academia and entertainment interviewed was Beijing University (Beida) professor and cultural critic Zhang Yiwu, whose remark drew the sharpest response. Professor Zhang suggested that the “Chinese Dream” of the 21st century was embodied in the movie actress Zhang Ziyi’s ability to become one of the Hollywood screen idols she had admired as a child.

The subsequent headline in the Chinese media, “Beida Professor Says Zhang Ziyi is better than Confucius!” roused furious debates. Immediate responses on the internet were overwhelmingly negative. Critics attacked Zhang Yiwu for being shallow and snobbish: how could he, a faculty member at the number one university in China, place the value of a crass young movie star above the sage philosopher just because she was getting popular among foreigners? Professor Zhang had to rush to explain that he had no intention of putting down the great Confucius. Rather, he was simply pointing out that the soul of traditional Chinese culture must pass through new mass culture before it can spread outward. It is only in this sense that one Zhang Ziyi is 10,000 times more influential than Confucius. Some commentators pointed out that the reaction might have been less negative had Professor Zhang cited Yao Ming, the star Chinese basketball player in the National Basketball Association, rather than Zhang Ziyi, who has in comparison never been a beloved icon in China. The actress has been stereotyped as a ruthless go-getter, and her recent role in “Memoirs of a Geisha” as a Japanese Geisha was frowned upon as a distasteful choice.

Although the grumbling went on for some days, debaters grew more reasonable and the professor was more or less forgiven. Perhaps more importantly, the critics, having ventilated, soon lost their heat. Zhang Ziyi’s glamorous face continues to dominate the covers of glossy lifestyle magazines at newsstands. After all, too many things are happening in China and the public’s attention span has shortened: most of the controversies now remain only briefly in the spotlight before the media and the people turn their attention to the next hot issue.

The controversy over Zhang Ziyi conveys a flavor of the current cultural atmosphere in China. It also helps to highlight some of the current characteristics of Chinese pop culture, which may be summed up as the following.

- The field of popular culture in China today has tremendous force and energy.
- It is fraught with tension: there are fitful, schizophrenic, constant, and chaotic battles

between nationalistic emotions and cosmopolitan impulses, between desires aimed at traditional authority and yearnings for coherent values, and between the past and the future.

- It is a “Copycat Era.” Partly due to the derivative nature of many of the pop culture products and trends, there is a good deal of anxiety about creativity, recognition, and influence.

The soul of traditional Chinese culture must pass through new mass culture before it can spread outward.

- Entertainment, life style, and consumption issues increasingly occupy center stage, while serious, social and political discussions become marginalized. However, the space is porous and the latter exist despite censorship and self-censorship. Some of the trends of popular culture also

help breed what might be termed as “the culture of democracy in daily life.”

To better understand these traits, I will examine a few fields of popular culture in China and discuss recent trends in each.

THE INTERNET: A SOURCE OF FREEDOM

The growing use and impact of the internet is probably the most significant cultural phenomenon in China in the past 10 years. At present, China has the second largest internet population in the world after the United States. According to the latest account, there are over 100 million internet users in China, or about eight percent of the total population, and the figures are rising.

Does the spread of new technology help disseminate information, break down control, and speed up the growth of democracy? In 1989, the fax machine was praised because it helped spread the news about Tiananmen. In spring 2005, short text messages sent through cell phones were instrumental in the building up of anti-Japanese demonstrations in Beijing and Shanghai. Some Chinese websites display shockingly extreme nationalistic sentiments. Foreign companies wishing to enter the Chinese internet market will follow the Chinese rules of the game and enforce certain censorship, as demonstrated by Microsoft, Yahoo, and Google. Yet this is only a partial picture. In general, the internet is playing an important and positive role in opening up Chinese culture and connecting it to the world. If we take a longer and wider view, it is also helping to breed democratic values.

The phenomenon of blogging shows how, despite the prevalence of censorship, a culture of democracy is emerging through the everyday use of the internet. In the last two years, the blog has been the biggest phenomenon of the Chinese internet. Entering China in 2002, blogging became popular in late 2003 with the controversy over a young female sex columnist named Mu Zimei. Working for a Guangzhou urban life magazine, she wrote in her personal blog about her sexual affairs with various men. The entry about her one night affair with a well-known local rock musician was re-posted by someone onto a website and became an instant sensation. Sina.com, a major Chinese internet portal, claimed that for 10 days its Mu Zimei-related postings received 10 million hits a day. Mu was cursed by some as immoral and trashy, but hailed by others as a liberated woman, a daring performance artist, and even a cultural hero. Although she ended her sex column, she continued to write in her blog and later moved to a Beijing multimedia company where she has been operating her own pod cast site. Her overnight fame drew book contracts and a huge amount

of media coverage and debate, including a report in the New York Times by Jim Yardley, who viewed Mu Zimei as a kind of “China’s Madonna.”

Since the Mu Zimei incident, blogging has been rapidly spreading in China. Since channels of free, individualistic expression and communication are still limited in China, the blog has emerged as a new means and space for self-expression, self-advertisement, as well as public discussion and commentary. All kinds of people have started their own blog, including urban professionals, students, businessmen, actors, singers, and journalists, some writing in diary form, and others using it as a public forum.

A turning point occurred when Sina established their “Celebrity Blog” in early 2006. Sina designed their blogs smartly, enlisting a long list of famous people such as movie stars, pop singers, best-selling authors, artists, and rich businessmen to set up their personal blogs on Sina. Its front page featured a board of “best blog essays”, including short pieces with eye-catching titles on popular topics. Following Sina’s instant success, all major internet portals in China have established similar group blogs. However, such trends have commercialized blogging, which has now become a mixed stage or a new vehicle for stardom. It is a public opinion board where topical subjects get discussed, amplified, and mediated, and also a new platform for instant fame, self-promotion, and easy entertainment. The voices are no longer private and natural.

An example of the evolving role of blogging as a medium of public exchange as well as personal fame is the incident sparked by the obscure young video artist Hu Ge, who made a short parody of “The Promise”, the new blockbuster by Chen Kaige, and circulated it on the internet. In response, Chen’s former wife Hung Huang opened her blog on Sina with a short satirical commentary about Chen and the movie. Hu’s parody was a summer sensation while Hung’s blog received half a million hits within days. Chen’s movie became infamous because of the universal panning in so many blogs, even though traditional media like television, newspapers, and magazines, had kowtowed to its huge publicity campaign.

Nevertheless, while such “soft poking” is allowed, blogs with hard-hitting political commentary still suffer severe treatment. An example is one of the earliest and most popular political blogs by Michael Anti, a young journalist and researcher for the New York Times’ Beijing bureau. Although Anti’s blog received about 7,000 hits on a daily basis, it was eventually shut down for its harsh political views.

Still, the internet is generally a freer space than traditional media. Part of this freedom has to do with the sheer quantity and speed of the content, the wide range of communication channels, and the fact that people can post comments anonymously. Such attributes of the internet make control and punishment more difficult. As a result, even though official censorship is a daily reality, we can still find much more critical information on the internet than anywhere else in China. Various kinds of critical reports and opinion pieces are circulated via email or tucked into inconspicuous corners of the internet. Even in the many civil rights cases of the last five years, the internet has often played a crucial role in mobilizing support and successful intervention.

THE MOVIES: IN A SLUMP?

Although Chinese movies continue to receive positive press at international film festivals, there is a sense of crisis within China’s movie industry and among Chinese film makers. Money is a big factor. With the deepening of market reforms, movie-making became commercialized in the 1990s. The movie budget drastically increased with the salaries of high-profile actors, overseas post-production costs, and marketing and promotion campaigns. Many local cinema houses, crude, single-

screen facilities built from the 1950s to the 1970s, were dilapidated and had to be upgraded into multi-screen complexes with imported electronic equipments and comfortable seats catering to the emerging middle class. These improvements were absorbed by ticket prices, which skyrocketed. In 1989, with a movie ticket costing just 0.25 yuan, cinema houses attracted full audiences, from migrant workers to intellectuals. By 2003, a movie ticket cost between 30 and 50 yuan; today, it is 60 yuan and sometimes more in major cities. Ticket prices have risen over 200 times since 1989, significantly outpacing the rise in income during the same period.

While going to the movies has become a luxury that the average person cannot afford, television now offers more entertainment, including a movie channel that shows both old and fairly recent films. At the same time, buying cheap, pirated DVDs has become a rampant, unstoppable phenomenon.

In an environment of censorship, many directors opt for politically safe and commercially profitable genres.

As a result, most people prefer to stay at home watching DVDs or the movie channel on television. Since the decline of home audiences and box office returns, international distribution has become important, as well as the need to cater to foreign tastes. Meanwhile, censorship has continued, and “unruly” directors and works have been periodically banned or penalized.

To survive in such an environment, many directors have opted for politically safe and commercially profitable genres such as martial arts. For example, the three top Chinese directors, Zhang Yimou, Chen Kaige, and Feng Xiaogang, have in recent years turned to making high-budget kungfu movies. Cinema houses are thus dominated by both imported Hollywood blockbusters and Chinese kungfu movies. Critics warn that such domination may hamper the healthy development of a more diversified film scene.

However, there are some hopeful signs of the revival of the Chinese movie industry. For example, official bans of the last 10 years were lifted from young underground film makers like Jia Zhangke, Wang Xiaoshuai, and others. Young artists are taking up digital recording to shoot low-budget movies that reflect a new consciousness of social reality. As Jia Zhangke puts it, the Chinese movie industry may be dead right now, but the Chinese movie is still alive and well. Low-budget movies by young directors are emerging and winning critical support. For example, Ning Hao’s “Mad Stone (Fengkuang de Shitou),” a clever comedy with a lot of contemporary black humor, was a huge hit last summer, while having cost less than 3 million yuan to make. Such developments suggest that more commercially savvy and artistically mature movies will be coming out in the future.

TELEVISION: CHEAP AND POPULAR

Compared to traditional media, such as books, newspapers, and magazines, television is under the strictest official scrutiny because of its massive impact on society. News coverage must follow officially designated, politically correct guidelines and help build China’s “harmonious society.” In other words, no station or program can go against the official line on Taiwan, North Korea, a Party Congress, or any key policy issues. Still, overall ideological content has been toned down as a large segment of television programs is taken up by daily topics and entertainment, where the space is more flexible. China Central Television (CCTV)’s show “News Probing” runs many shows of investigative journalism exposing corruption cases and social problems, but only up to a certain level.

Consumption and entertainment are growing forces on television, where market and audience ratings are central. The number of television channels has reached over 60, featuring variety shows, music television, game shows, cooking shows, health shows, shows on real estate and finance, and talk-shows on current topics like money, education, celebrity, and divorce. In particular, a large amount of soap operas and sitcoms are produced annually, of which two genres have been popular in recent years. One is the historical drama, a long series about Qing emperors, well-liked by male audiences. The other is the South Korean family soap opera, which has attracted a large following among older female audiences. However, there have been other Chinese hits such as "Divorce, Chinese Style," which portrays the pressure of rapidly changing urban life and moral values on marriage and gender relationships. Another example is "Winter Solstice," which depicts the negative impact of rapid development and money on unscrupulous individuals. A trend of re-writing and humanizing revolutionary history is also reflected in a number of popular television series about military life, the republican era, and the Cultural Revolution.

Watching television is still the single most common way of relaxation and entertainment in China. However, although craftsmanship has improved in the making of many television shows, plenty of low-quality material is being produced. A much discussed problem of Chinese television is the lack of originality and creativity. There are many theories and explanations for this "Copycat Era", such as the destruction of the Cultural Revolution, the rigidity of an exam-oriented education, the damaging effect of ideological control, short-sighted commercialism, and Western cultural domination. Professor Zhang Yiwu may represent the optimistic view on China's cultural dream in the 21st century, but many have far more sober attitudes.

"Super Girl Contest," the "American Idol"-inspired show launched on Hunan Satellite Television Station in summer 2005, demonstrates the lack of originality of Chinese television products as well as the political implications of changing popular interests. 150 thousand young girls from ordinary families with dreams of rising to stardom participated in the singing contest, which captured millions of people across the nation - about 400 million watched it by one account. The active participation of so many people in watching, discussing, and voting for the candidates prompted many analysts to interpret the phenomenon as the Chinese people's desire for democracy. This suggestion seems to be an exaggeration: there is a big difference between the interest in electing a favorite signer and the collective will and ability to elect a political leader. Although the future is difficult to predict, at present there appears to be no consensus among the population or elite that China is ready for Western-style democratic politics. At any rate, the "Super Girl Contest" has also been criticized by government officials as a commercial scheme catering to low-brow taste. The "Super Girl" show of summer 2006 has already been tamed by new government regulations, losing a good deal of its previous energy and mass appeal.

Nevertheless, while its political implications are unclear, a phenomenon like "Super Girl" does offer a sense of the cultural sensibilities of the young Chinese: growing up in the reform era and living in better materialistic conditions, they have been consumers of pop cultures from the West and other parts of Asia, sing the same songs, wear the same clothes and have the same hairstyles, and share their Western and Asian peers' dream for success and a freer life. These young Chinese are not so interested in politics in the traditional sense, but are drawn into self-expression, fame, and success. The "Super Girl" phenomenon also shows the derivative nature of current youth culture trends in China: not only is the show's formula a copy of British and American television shows, but even the songs performed by the contestants are often copies of American or Asian pop songs. In television, as in movies and pop music, American and other Asian pop cultures remain a

major influence and reference point. For example, “Sex and City” spun off a similar Chinese television series in 2005, while a movie and a book launched the following year both advertised themselves as “the Chinese version of ‘Sex and the City.’”

LITERATURE: TENSIONS BETWEEN OLD AND NEW

While readership for literary fiction and circulation of literary magazines have declined since the late 1980s, the emergence of a group of very young writers caused a stir in recent years. Born in the 1980s, most of these young authors posted their first writings on the internet and built their following there before publishing in book form. Contemporary urban life, romance, and sentiments of alienation are recurrent themes in their works. So far, a lot of their work is a kind of “lite” urban literature. A recent quarrel involving Han Han, one of the most popular authors of this group, is worth our attention.

Han dropped out of college but published a bestselling novel at 17, later becoming a racecar driver and youth icon. Part of his mass appeal is his unruly “bad boy” image. When Bai Ye, an older literary critic, snubbed the young writers for succeeding in the market but not publishing in the

Big cities like Beijing and Shanghai are decried as vast experimentation sites for foreign architects.

traditionally more prestigious literary journals or winning critical acclaim, Han wrote a scathing essay in his blog criticizing Chinese literary circles. Offended by Han’s remarks, several prominent literary figures engaged in an online fight over issues of power, status, and commercial corruption. Essentially, this was a struggle between the younger generation and the old guard, from which the young emerged as winners. Although

Han rightly and smartly criticized the corrupt snobbery of the old literary elite, the debate revealed some problems of China’s new youth culture when tens of thousands of Han’s young fans used extremely violent language in attacking his opponents. This was also not the first time that Chinese internet users showed their tendency toward violence and suppressed anger.

ARCHITECTURE AND URBAN DEVELOPMENT: OPENING TO NEW IDEAS

China has been a giant construction site during the last 20 years. Big cities like Beijing and Shanghai are decried by some Chinese critics as vast experimentation sites for foreign architects. It is true that most of the glamorous big projects are contracted out to Westerners like Rem Koolhaas and Paul Andreu, while local architects usually do their legwork. Exploding demand for housing does not mean an artistic renaissance: a lot of the new high-rise buildings are decidedly unstylish, or even ugly.

However, there are hopeful signs even in the midst of this chaotic urban landscape of clashing styles. Consciousness about cultural heritage and historical preservation is rising, partly motivated by commercial interest such as tourism. A generation of young Chinese architects is working with

and learning firsthand from major Western architectural firms, while some of those trained abroad are returning to China. The energy and progress in this area suggest that China may eventually produce its own Le Corbusier and I.M. Pei, who might invent a new architectural culture that brings tradition, environmental concern, futuristic vision, and technology into a unique fusion. What is important about the current trends is that Chinese attitudes are becoming more open and sensitive, rather than conservative and narrow.

CONCLUSION

The situation of Chinese media can be summed up with “three Cs”: Control, Change, and Chaos. These “three Cs” can also aptly describe the popular culture scene in China today. Control is definitely still a major factor, although with the great proliferation of pop culture production and the rapid expansion of the internet and international communication, news travels fast and the circulation of information has become much harder to monitor. The present authorities, more cautious and mindful of their own image, have adopted a softer and more artful approach in censoring the arts, while a younger generation of Chinese is showing a greater appetite for entertainment and lifestyle issues than politics. In movies, television, literature, and architecture, commercialization and globalization have often led to chaotic trends of imitation, clashing styles, facile, shoddy products, and furious debates. In search of a new modern identity, many Chinese are torn between the past and the future. At the same time, artists and intellectuals are trying to find a healthy balance between heritage, assimilation, and creativity. China’s rapidly evolving culture not only reflects the country’s vibrant transformation, but also represents an important engine of change in Chinese people’s lives. Although one can hardly describe it all or predict its future, there are enough encouraging signs from the different categories of culture to make one cautiously optimistic about the direction of cultural change in China.

Artists and intellectuals are trying to find a healthy balance between heritage, assimilation, and creativity.

DAY III

WHAT CHINA NEEDS IN THE WORLD AND FROM THE UNITED STATES

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WHAT DOES CHINA NEED IN GLOBAL AFFAIRS?

In recent years, China's increased participation in global affairs has diversified Beijing's interests while making Chinese foreign policy more sophisticated. In general, China's international behavior is driven by a combination of China's national aspirations, national security, economic requirements, and its needs to cope with non-traditional security problems.

National Aspirations

From the Opium War of 1840 to the founding of the People's Republic of China in 1949, China's modern history was characterized by foreign invasion and occupation, political turmoil, civil wars, and poverty. Bitter memories of this "century of national humiliation" are still vivid among educated Chinese today. The Japanese invasion from 1931 to 1945, with the war atrocities, was a particularly traumatic period.

Even in the first two decades after the PRC's establishment, Beijing was treated by the Western world largely as an "international outlaw," whereas the "Republic of China" in Taiwan was recognized as representing China in the United Nations and other international organizations. China has been gradually accepted as a full-fledged international player since the U.S.-China rapprochement in the 1970s, especially since the end of the Cold War. Besides gaining formal membership in the G8, China has joined virtually all existing international organizations and regimes. However, the "national humiliation mentality" or "siege mentality" lingers on among Chinese elites, who may cite a number of events to illustrate that their country is not yet enjoying the great power status that they aspire for. For example, Western sanctions imposed on Beijing after the Tiananmen incident in 1989 have not been fully lifted, as Washington puts pressure on the European Union against resuming arms sales to China. Most Chinese citizens are still convinced that the NATO bombing of China's embassy in Belgrade in 1999 was a deliberate act intended to humiliate and "punish" China for its opposition to the Kosovo War. Japan's unrepentant attitude toward its World War II crimes, exemplified by Japanese leaders' repeated visits to the Yasukuni Shrine in recent years, is an issue affecting national dignity in China.

As China's national strength rises rapidly with its expanding economic size and evident social progress, its national pride grows accordingly. The sudden gain in global power and prestige makes it difficult for China to adjust itself to meet the requirements of a "responsible great power" – or in

the words of Robert Zoellick, a “responsible stakeholder”¹ – when a large part of Chinese conceptions and experiences in world politics are still linked to past sufferings and indignation. It is also hard for Chinese to comprehend various assertions that China is a “threat” to the outside world. The conventional interpretation of China’s portrayal as a threat is that international schemes and conspiracies are being contrived mainly by the United States, other Western powers, and increasingly Japan, to prevent China from growing into a genuinely powerful and respected nation. In the economic realm, Chinese suspect that biases and prejudices against China are driving Western countries to accuse China of dumping consumer goods, violating intellectual property rights,

It is hard for Chinese to comprehend various assertions that China is a “threat” to the outside world.

hunting for energy supplies, lacking military transparency, and so on. In other words, negative attitudes towards China are mostly interpreted in the Chinese conceptual framework of Westerners’ hostilities, biases, and misunderstandings. In response, most Chinese seem to agree that Western “misinterpretations” and “malign accusations” should be rejected and rebutted.

Mainland Chinese believe that Taiwan is territorial-ly and culturally part of China. National reunification, therefore, is associated in China’s national consciousness with heightened national power and prestige,

while continued division across the Taiwan Strait is viewed as a reflection of the PRC’s weakness and vulnerability. While the pro-independence forces in Taiwan are being circumscribed by internal political discords and scandals, the PRC cannot afford to be complacent about the long-term prospects, as no party of political weight in Taiwan explicitly advocates reunification, and separatist tendencies remain. The rulers of the “Republic of China” in Taiwan even want to remove “China” from Taiwan’s official name, and Taiwan is still recognized by over 20 small countries in the world, mostly in Latin America and Africa. A great part of China’s diplomatic resources have been used to isolate Taiwan politically in international affairs, and these efforts will continue for an indefinite period of time.

China’s cultural influences have expanded in recent years, as foreigners are increasingly interested in Chinese language and culture. The Chinese government is promoting its “soft power” in the world by helping establish dozens of “Confucius Schools” and strengthening associations with ethnic Chinese overseas. On the one hand, Chinese students and younger intellectuals remain enthusiastic about going to advanced countries for education and training,² with Oscar, Nobel, and Harvard as continued hallmarks of cultural, scientific and educational excellence. On the other hand, many of them hope to see China’s “broad and profound” culture spread to other parts of the world. As a means to enhance international understanding and China’s prestige, China is also encouraging and helping foreigners to study or teach in China.

There have been an unprecedented number of heated debates among Chinese scholars and analysts regarding how to assess China’s power, influence, and economic performance relative to other countries, especially the United States, Japan, and India. Some optimists predict that in terms of economic power, China will catch up with the United States in 20 years, and surpass Japan in 10 years. Still, many others point to the weaknesses in China’s science and technology and bottlenecks in its economic growth, arguing against what they see as exaggerations of China’s strength. The Beijing leadership seems very cautious and sober-minded in its own projection of Chinese power, as reflected in its decision to change the term “peaceful rise” into “peaceful development” in defin-

ing China's road to great power status. This new discourse has been supplemented by a growing interest in historical models of development of other great powers. An officially endorsed documentary, released on China Central Television, *The Rise of Great Powers*, drew a great deal of public attention toward the end of 2006.

China's national aspirations are shaped by a unique superiority-inferiority complex, and are likely to attract an increasing amount of global attention, which may not necessarily be in China's favor. How Chinese political elites manage this challenge will be of critical importance to China's foreign relations as well as its domestic social transformation.

National Security

A key strategic goal of the PRC is to promote a peaceful and conducive international environment for its modernization. To attain such a goal, China needs to work hard to ensure a peaceful solution to the North Korean nuclear issue and to prevent an arms race and nuclear proliferation in East Asia. China also seeks a peaceful settlement of its territorial disputes with neighboring countries. Whereas China has already settled most of its border disputes, notably with Russia, some problems persist, including with Japan over the demarcation of the East China Sea, with a few Southeast Asian countries over the South China Sea, and with India over a couple of border areas.

With the enlargement of China's economic activities in and beyond Asia, Chinese concerns about international security have expanded to include regional security in many other geographical areas. China's security concerns also encompass maritime security along key sea lanes, which is necessary for securing energy supplies as well as international trade. Another security threat is international terrorism, particularly in China's preparations for the 2008 Olympic Games in Beijing. China is actively promoting a new concept of "building a harmonious world," although its specific meaning is subject to deliberation. In view of China's international behavior in the reform era, especially since the end of the Cold War, there is little reason to doubt its sincerity in striving for world peace and stability. In this sense, China is a "status quo power" rather than a "revolutionary force" that would seriously challenge the current world order.

China's strategic focus remains in Asia, and Chinese security in East Asia is circumscribed by two major regional mechanisms. One is the U.S.-led security arrangements centered on American military presence in the Western Pacific, including the U.S.-Japan alliance, U.S.-South Korean alliance, and U.S. military relationships with a few ASEAN countries and Australia. Since the end of the Cold War, Beijing has perceived the continuation and strengthening of these arrangements as negative geopolitical trends. As reasons for concern, Chinese security analysts point to the expansion of NATO, the U.S. military presence in Central Asia, the strengthening of the U.S.-Japan military alliance, Japan's discernable assertiveness toward China, the building of an American missile defense system assisted by Japan in the Western Pacific, and the redeployment of U.S. forces, directed at least partially at China.

The other mechanism is ASEAN as a regional organization and forum, which has been depicted in Chinese official statements and media as a positive element. Beijing is participating actively in

Chinese seem to agree that Western "misinterpretations" and "malign accusations" should be rejected and rebutted.

Asian Regional Forum (ARF) and other mechanisms sponsored by ASEAN. However, the 1997 Asian financial crisis and its aftermath in Southeast Asia seem to have debilitated ASEAN's functions while slowing the process of regionalization. In the years to come, ASEAN is unlikely to play a leading role in establishing an East Asian regional security framework. Given the consolidation of U.S. security arrangements in Asia and the inertia of ASEAN's security role, it is hard to conceive of a multilateral, region-wise "concert of powers" in the near future in which China, the United

China's national aspirations are shaped by a unique superiority-inferiority complex.

States, Japan, South Korea, Australia, and ASEAN countries could coordinate their security policies to maintain stability and order. China's realistic goal, therefore, is to prevent the formulation of an anti-China framework rather than building multilateral security arrangements on its own.

Meanwhile, without any doubt, China is seriously accelerating its military modernization in accordance with its economic growth and threat perceptions. It does not make a lot of sense to debate the exact amount of China's defense spending, as its weaponry and military technology lag far behind its potential rivals, and Beijing is determined to make its deterrence against Taiwan's separatist movement credible.

A peculiar Chinese security concern is what it calls "political security," or domestic political stability. Chinese history is inundated with events in which internal uprisings and divisions invited external invasions and intervention. The Chinese government and political elites are particularly attentive to international influences that touch upon China's domestic vulnerabilities, including ethnic tensions, religious sensitivities, and political discord. As a result, China is vigilantly watching the "color revolutions" in some former Soviet states, and Washington's declared support for democratization in other countries, as expounded by Condoleezza Rice's call for "transformational diplomacy."³

Economic Needs

An increasingly important motivation in China's foreign affairs concerns the need to acquire natural resources, not only energy, but also minerals and other raw materials necessary to fuel its economic development. In response to international concerns that China's rapidly growing consumption of natural resources will significantly harm global markets and ecology, many Chinese commentators emphasize the fact that imports only account for a small part of China's energy consumption. However, it is undeniable that China is increasingly dependent on energy imports and that international competition in energy procurement is likely to intensify.

Energy shortages have been an increasing source of concern in China recently. In 2002, China replaced Japan as the second largest oil consumer in the world.⁴ While imported oil meets only about 12 percent of China's total energy needs, its energy lifelines increasingly lead to the volatile Middle East. The Arab countries have been China's largest crude oil suppliers, with 43.7 percent of China's total oil imports coming from the Arab world in 2005, and about 60 percent from the Persian Gulf region.⁵ Supertankers carrying the oil must pass through the pirate-infested Malacca Straits off Malaysia, where the shipment of oil is protected by the U.S. Navy. Although China is beefing up its own navy, it still cannot protect faraway sea lanes. By 2020, 70 percent of China's oil consumption will have to be met by imports.⁶ There are conventional worries in both China and

abroad that such problems may contribute to geopolitical competition between great powers.

Real solutions to these issues, however, lie in more effective transnational cooperation rather than great power rivalry. Water shortages, desertification, and other ecological degradation in China are pushing the Chinese in the direction of cooperation. China has been constructing a long-term development strategy for its energy production and supplies, which takes geopolitical factors into consideration. The policy objective is to stabilize relations with the United States and Japan, and to strengthen ties with Russia, Central Asian states, and other oil producers. In addition, China needs to build a stronger navy to protect the safety of international sea lanes.

China's GDP has grown at an annual rate of 8 to 10 percent, while its total foreign trade volume has expanded by over 20 percent annually. This imbalance has made the Chinese economy increasingly dependent on the global market, with foreign trade accounting for 60 to 80 percent of GDP, according to varying statistics. Many warn that such a degree of dependency is unsustainable and may jeopardize China's economic security. Therefore, Beijing has called for an increase in domestic consumption as the main engine for sustaining economic growth. In fact, serious political debate in China surrounds the fear of some that China has become over-dependent on foreign trade and investment and, consequently, too vulnerable to international competition. However, such a level of reliance on the world economy is unlikely to be reversed in the near future. At any rate, China has one of the most open economies in the world. In addition, its overseas investment is expanding rapidly at a rate of over 25 percent.

Non-Traditional Security Problems

In recent years, China witnessed several crises, notably SARS, avian flu, and the Songhua River contamination, linked to non-traditional security problems like ecological degradation, pandemics, illegal immigration, and drug trafficking. There are reasons to believe that these problems may be exacerbated by the incompatibility between China's opaque institutions and international demands for more transparency and accountability on the part of the Chinese government. On the other hand, China needs to cooperate with intergovernmental as well as nongovernmental organizations in coping with these problems.

The flow of people and information between China and the outside world has dramatically intensified in recent years. It is estimated that the total number of mainland Chinese traveling abroad, including tourists, reached 32 million in 2005.⁷ By the year 2020, China will account for the largest number of international travelers. Such a scale of demographic mobility will inevitably result in more problems as well as needs for extensive global cooperation. With so many Chinese citizens working and traveling abroad, protection of their lives and interests extends beyond Chinese national borders. Expanding commercial and other activities abroad have modified Chinese thinking about such traditional principles as sovereignty and noninterference in other countries' domestic affairs, and participation in UN peacekeeping operations. In fact, Chinese peacekeepers outnumber those of any other single permanent member of the UN Security Council.

WHAT DOES CHINA NEED FROM THE UNITED STATES?

In light of what China needs in the world as described above, it is not difficult to imagine what it needs from the United States. In the 1970s and 1980s, Beijing needed Washington's support mainly to balance Moscow's military pressure on China. In the 1990s, it was in China's best inter-

est to gain access to the American market for its labor-intensive products, and hence the Most Favored Nation status. China continued to benefit from absorbing American capital, technological know-how, education, and management skills. Through strenuous negotiations, particularly with the U.S. Trade Representative, China secured membership in the WTO. During that period, the tacit understanding shared by a large number of Chinese political elites was that “China needs the United States more than the United States needs China.”

Since 9/11, with the rise of China’s economic power and international status, there have been subtle changes in Chinese attitudes toward America. In China’s official line, pronounced criticisms of “U.S. hegemony” have subsided. Responding to the new global security circumstances, Beijing has concluded that Washington will not perceive China as a major strategic rival in the foreseeable

China is seeking a stable, mature relationship with the United States

future. America’s quarrels with European powers and Russia over Iraq and other security issues, together with popular grievances around the world against U.S. unilateralism, have further convinced China that there are counterbalancing forces to resist the American hegemon.

Looking at the statistics related to America’s “hard power,” such as its total GDP, economic growth rate, defense budget, military prowess, and R&D expenditure, the United States is by far the world’s only superpower, and will remain so for at least 20 years to come. In some measurable terms, its hard power will grow even stronger relative to other great powers, including China. There is no illusion in the Chinese leadership that China will, in any foreseeable future, be at par with the United States in terms of great power status. However, due in part to the Bush administration’s unilateral approach to global affairs and its failed policy toward Iraq and the Islamic world as a whole, America’s “soft power” (power to influence other countries’ behavior by non-coercive means) is definitely declining. Anti-Americanism is growing in most parts of the world, and U.S. relations with Europe, Russia, and many Latin American countries are facing increased difficulties. In their travels around the globe and discussions with foreign leaders, Chinese leaders are deeply impressed with both America’s influence and other nations’ complaints about U.S. behavior.

China is benefiting from a strong U.S. economy but feels increasingly pressured by U.S. military power and presence in China’s peripheries. The actual and possible decline in U.S. soft power is also a double-edged sword to China. On the one hand, a weakened U.S. position in the world, along with its tainted image, distracted attention, and lack of a coherent global strategy, has reduced Chinese apprehensions about a “unipolar world” dominated by the United States, which featured prominently in Beijing’s policy lines a few years ago. On the other hand, the world might be less stable and predictable, and the existing international institutions weakened, with a psychologically wounded and less determined United States. In fact, despite the pronounced opposition to U.S. hegemony, China has been a major beneficiary of the existing world order.

Beijing has appeared more cooperative with Washington in global affairs, as shown in the cases of the North Korean and Iranian nuclear issues and anti-terrorist campaigns. Indeed, Beijing is carrying out a more pragmatic and moderate policy toward the United States compared to its previous diplomatic rhetoric and practices. This moderation is based on the realization of the stark fact that China’s power and influence are circumscribed by those of the United States and its allies. While the Bush administration’s foreign policy is assertive and unilateral in nature, its main strate-

gic spearhead is directed at Islamic radicalism rather than China. It would be foolhardy for China to offend or challenge the world's only superpower in cases where no Chinese key security or economic interests are being threatened by American aggressiveness.

Beijing's policy toward Washington has been remarkably consistent since 9/11. Its economic policy is unswervingly to promote bilateral trade and attract U.S. investment in China. China-U.S. bilateral trade surpassed \$200 billion in 2005⁸ and the United States remains China's most important economic partner. Beijing has made compromises on a few economic disputes and has accommodated U.S. calls for reevaluating the renminbi. The two countries have been working effectively on many global issues like energy development, pandemic diseases, and drug trafficking. China has supported America's counter-terrorist actions in a variety of ways, including sharing intelligence with Washington quietly and allowing the Federal Bureau of Intelligence (FBI) to establish an office at the U.S. Embassy in Beijing. Although China openly opposed the launching of the Iraq War in 2003, it did not join the French, Germans, and Russians in formulating a bloc to impede U.S. actions. In the North Korean nuclear issue, Beijing has coordinated the six-party talks, and the Bush administration has appreciated China's intermediary role. In Asian affairs, despite the reservations about U.S. security alliances with regional states, China has made little effort to squeeze America out of Asia. Finally, in APEC and other regional forums and institutions, the PRC is working together with the United States and other countries in dealing with economic and security problems of mutual concern.

Meanwhile, the tainted image and isolation of the United States in world affairs, brought about by its mishandling of Iraq, coupled with its apparent failure to narrow policy differences with many European and Latin American countries and with Russia, do have an impact on Chinese perceptions of America. To be sure, many Chinese still believe privately that "we need them (Americans) more than they need us." However, some Chinese observers are beginning to argue that "we need them less than before, and they need us more than before." Yet another unspoken Chinese sentiment is that "they could do more harm to us than we could do to them."

One may further contend that most of what China needs from the United States today could be analyzed in negative rather than positive terms. In other words, it is easier to point out what China does NOT want the American government to do than what China really wants from Washington. To illustrate this point,

- Few Chinese harbor illusions that the United States would be willing to help China achieve modernization objectives and enhance its international stature. What they can hope for is that the United States will NOT adopt a policy of containment against China or obstruct its national aspirations. In the international arena and media, Americans should NOT portray the PRC as a potential threat to world peace, the global economy, and the existing international order.
- It would be wishful thinking that America would facilitate China's reunification with Taiwan. What the Chinese are simply asking for from Washington is to NOT encourage and support Taiwan's *de jure* secession from the Mainland, and refrain from selling sophisticated weapons to Taiwan that might give it more muscle to resist Chinese calls for political reconciliation and economic integration based on the One China principle.
- There is no possibility that American politicians and strategists would be generally more

sympathetic toward China rather than Japan in disputes between the two Asian countries. China only hopes that America will NOT side with Japan in the current competition between the two Asian powers.

- Chinese leaders and political analysts understand the reasons why Americans do not have friendly feelings toward China's political system and leading ideology. They recognize the background of America's advocacy of democratization and are only concerned about how America's ideological obsession will affect its China policy. In other words, they do NOT want to see much American interference in Chinese politics and criticisms of China's human rights record.
- In bilateral economic ties, Washington (both executive and legislative branches) should NOT intervene too much and NOT impose political wills on commercial activities. There are excessive concerns, especially on Capitol Hill, about China's acquisitions of U.S. companies. Market forces should be allowed to drive economic decisions. The abortion of China National Offshore Oil Company's bid for UNOCAL in 2005 is a telling example. In fact, the difficulties Chinese oil companies have had in acquiring mainstream energy companies have fueled China's search for energy in such countries as Iran, Venezuela, and Sudan. In turn, China's relations with these countries add to U.S. suspicions of Beijing's strategic intentions.
- Further reevaluation of the renminbi is inevitable. Americans should NOT overly press China politically since such pressure would not produce positive results.

To sum up, China is seeking a stable, mature relationship with the United States and hopes the United States will NOT stand in its way for prosperity and unity. America is China's largest economic partner and also its potential strategic opponent.

It would not serve China's long-term interest to see global turbulences caused by rapidly declining U.S. influence. To be sure, the United States is backing Japan's bid for playing a larger role in the United Nations, and the U.S.-Japan security alliance is aimed partly at balancing China's military power. However, America's role in the China-U.S.-Japan trilateral interaction is not entirely negative, as U.S. officials and strategists privately tell the Japanese to manage their ties with China and South Korea with greater care. Similarly, Beijing and Washington share some common interests in preserving stability in the Taiwan Strait. Only with a cooperative relationship with the United States can China "borrow" America's influence in coping with such delicate regional issues.

It is undeniable, nonetheless, that both China and the United States are strategically hedging against each other. There are influential political thinkers in both countries who anticipate the other country to be their own country's major strategic rival. Policy makers in Washington are worried that China may want to exclude the United States from the East Asian community that is currently being conceived. Many American strategists view China's active role in the Shanghai Cooperation Organization (including four Central Asian states and Russia), and its increased influence in Southeast Asia, South Asia, and Australia, and elsewhere, as a long-term challenge. Consequently, Washington is trying hard to maintain American spheres of influence in Asia partly to thwart China's perceived efforts to become a dominant regional power at the expense of U.S. interests.

It is by no means easy for China to deal with this global giant and there are a great number of uncertainties along the road ahead. What is certain is that Chinese leaders will continue to be defensive and prudent in U.S.-China relations, and resist temptations to shape any anti-U.S. coalition in Asia and the world.

ENDNOTES

- 1 In a major speech to the National Committee on U.S.-China Relations in September 2005, Deputy Secretary of State Robert Zoellick publicly applied the term “stakeholder” to China’s role in international society.
- 2 In 2005 alone, China sent 118,500, students abroad and attracted 141,000 foreigners.
- 3 U.S. Secretary of State Condoleezza Rice articulated “transformational diplomacy” by declaring that “(we) seek to use America’s diplomatic power to help foreign citizens to better their own lives, and to build their own nations, and to transform their own futures. ... Now, to advance transformational diplomacy all around the world, we in the State Department must rise to answer a new historic calling. We must begin to lay new diplomatic foundations to secure a future of freedom for all people.”
- 4 In 2002, China consumed 245.7 Mt while Japan consumed 2.426 Mt. See National Bureau of Statistics of China, *China Statistical Yearbook 2003*, Beijing: China Statistical Publishing House.
- 5 “China, Arab States to Hold First Oil Meeting,” *Xinhua News*, June 1, 2006, http://news.xinhuanet.com/english/2006-06/01/content_4632362.htm.
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Strategic Competition,
Regional Reactions,
and Global Gambits

DAY IV

**MEET THE NEIGHBORS:
REGIONAL RESPONSES TO CHINA'S RISE**

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In fairy tales in Japan and other parts of Asia the ogre is a perennial character. Possessed of supernatural powers and a charming wit, the ogre can spin his magic to bring good weather and a bumper rice harvest. However, the ogre can also turn into a horrific, red-faced beast dispensing cruel punishment upon a village for reasons completely beyond the poor farmers' control. Across Asia today, one hears echoes of these fairy tales as governments speak of the "opportunities" and "risks" attendant with the rise of Chinese power and influence in the region. Like the rice farmers in tales of old, Asian governments are doing their best to position themselves to reap the benefits of Chinese economic growth, while hedging against the possibility that China's increasing power might undermine their security.

As a result, there is no consistent trend that international relations theorists might isolate to predict whether the region will ultimately balance against Chinese power or bandwagon with Beijing. The reality is that almost every regional power is doing some aspect of both today. An assessment of regional responses to China is further complicated by the dynamic identity politics within each of China's neighbors. China's rise has become a central part of the debate about what it is to be "Korean" or "Japanese" or even "Australian" in the 21st century – is it to be integrated into a harmonious East Asia Community or is it to strive for sovereignty, territorial integrity, and a rightful place in the traditional Asian hierarchical order? Finally, continued U.S. strategic leadership in Asia means that the region's powers do not yet have to choose between strategies of balancing or bandwagoning.

It is precisely because the United States does not want Asia to have to make such a choice that we must keep a close watch on how countries in the region are dealing with China today. This paper provides a snapshot of how the region's major players are organizing themselves to both engage and hedge against China's rise and how China's growing influence is affecting these countries' own sense of identity and purpose in Asia. The paper concludes with a consideration of the implications for the United States.

First, however, it is important to begin by reviewing what we can say about China's strategy for Asia.

CHINA'S ASIA STRATEGY

Historians continue to debate whether a consolidation of power within China has traditionally led to expansionism or contributed to broader regional stability based on Sino-centric cultural and economic activity.¹ Chinese leaders do not appear to have the luxury of such debates, however, and

remain preoccupied with the threats to their legitimacy and national stability from within, whether it is “splittism” in Taiwan, growing regional development gaps, rampant corruption, an aging society with no social safety net, or energy shortages and environmental degradation. Moreover, having carefully studied the international system’s response to the rapid rise of Japan and Germany in the last century, China’s leaders have concluded that China benefits too much from the current system to risk being seen as a revisionist power. As a result, it has become a mainstay of Beijing’s explanations of its Asia strategy that China must focus on “peaceful development” enhanced by a stable and benign external environment.

The rise of China may make the region both rich and more stable.

That does not mean, however, that China is a passive player in the region. While not an overtly expansionist or revisionist power, China is using all of the tools of the modern nation state to shape its external environment, maximize access to resources, and constrain the ability of other states to affect its internal affairs. Nor does “peaceful development” yet equate with China being a “stakeholder” in the international system that does more than pursue its narrow national interests, as exemplified by the following.

- China is modernizing its military. This includes an expanded ability to strike Taiwan with shorter range missiles; Japan, India, and the Philippines with medium range missiles; and the United States with longer range ICBMs. The PLA is also introducing sea skimming missiles, quieter submarines, and asymmetric capabilities in cyberspace and outer-space (anti-satellite missiles) all designed to keep U.S. carrier battle groups away from littoral areas around China in times of crisis.
- China is stepping up its diplomacy in the region, including a new embrace of multilateralism and efforts to create Asian-only institutions such as the Shanghai Cooperation Organization and the ASEAN Plus Three.
- China is utilizing soft power, for example through the establishment of Confucian Institutes and promotion of concepts of “non-interference in internal affairs” as a buttress against U.S. and global pressure for adherence to universal norms.
- China has been relentless in its pursuit of energy resources, exploiting the isolation of regimes like Burma to secure gas and oil contracts and conducting unilateral drilling in waters claimed by Japan.
- China has used its commercial power to threaten business interests in countries that take positions unfavorable to Beijing (Taiwan, Japan, and the United States have all been targets).²

Of course, China is also making almost every country in Asia richer and has been solicitous of “strategic partnerships” rather than open confrontation, including with the United States. The rise of China may serve to make the region both rich and more stable. For now, however, Beijing’s mercantilism, defense build-up and diplomatic activism in the region have brought as many concerns about the future as China’s economy has encouragement.

JAPAN

Perhaps no country in Asia has been more affected by China’s rise than Japan. Throughout the post-war period Japan was closely aligned with the United States against the Soviet Union, but

Japanese leaders believed that Beijing would eventually split from Moscow and allow a Sino-Japanese entente that would provide a more balanced relationship with the United States. That hope peaked with the end of the Cold War and then rapidly evaporated as Beijing tested nuclear weapons and bracketed Taiwan with missiles in 1995 and 1996. The collapse of the Japanese economic model and the onset of protracted recession only further deepened the Japanese national angst about China and Japan's own future in Asia. China's refusal to acknowledge Japan's right to a larger international role and deliberate efforts to undercut Japanese bids for the UN Security Council have further fueled the two nations' rivalry. The controversial Yasukuni Shrine visits of Prime Minister Koizumi are telling: over 50 percent of the Japanese public is opposed to the visits³, but also are offended by China telling Japan what to do on the issue.⁴ Over the past 10 years the Japanese media and politicians have hit a steady drumbeat about the Chinese military and diplomatic challenge to Japan. This trend will likely continue for at least the next 10 years.

Yet despite this marked shift, even Tokyo is employing a muddled mix of balancing and bandwagoning in response to China's rise. The most pronounced balancing behavior has been the tightening of the U.S.-Japan security alliance, beginning with the 1996 Clinton-Hashimoto joint declaration and then broadening in the Bush-Koizumi era with Japan's deployments in support of operations in Iraq and Afghanistan. Japan has also reached out to other major maritime powers around China's periphery, particularly India and Australia, to broaden naval, diplomatic, and strategic consultations. Japan and China are also engaged in an ideational competition to define the content of East Asian integration. Where China is pushing a broad agenda premised on the principle of non-interference in internal affairs, Japan has begun pushing for a "principled" multilateralism based on the advancement of democracy, rule of law, and good governance.⁵ Japan has also pulled India, Australia, and New Zealand into the new East Asian Summit to reinforce this democratic agenda and Tokyo continues to urge the United States to find a way to participate.

In contrast to these military, diplomatic, and ideational tools to balance China, it is also quite striking what traditional balancing behavior Japan has not employed. Japan has not increased defense spending above one percent of GDP (and procurement spending may actually go down to pay for the realignment of U.S. forces in Japan). Japan has not changed Article Nine of the Constitution, despite committee work within the ruling Liberal Democratic Party to draft new text. And Japan has done relatively little to remove obstacles to closer strategic relations with South Korea or Southeast Asia, including problem areas such as the visits to the Yasukuni Shrine and a protectionist agricultural policy that hinders economic partnership and free trade agreements.

In terms of economic policy, Japan has cut yen loans to China, which until recently amounted to about \$1 billion per year, and Japanese companies have signaled that they intend to diversify away from China by investing more in Southeast Asia and India (the so-called "China Plus One" strategy).⁶ However, Japan is hardly attempting to contain China's growth. Indeed, Sino-Japanese trade has outpaced U.S.-Japan trade for the past two years and Japanese companies have relied heavily on Chinese economic growth to help provide profits while they cleaned up their balance sheets and retired bad loans and assets from the bubble period. Moreover, China presents few direct threats of head-to-head competition against leading Japanese firms, where the real threat comes from leading Korean industries such as Samsung and Hyundai. And despite his insistence on continuing the Yasukuni Shrine visits over Chinese objections, Koizumi himself has repeatedly stated his optimism that Sino-Japanese economic relations will only improve in the years ahead.

Japan's relationship with China will therefore remain a complex mix of interdependence and intense rivalry, further complicated by a new generation's assertiveness in pursuit of Japanese national interests. For over two thousand years, either Japan or China has been on top in Asia. The two nations now have to come to terms with comparable levels of national power for the first time. It is unlikely they will find an easy equilibrium soon.

INDIA

Like Japan, India's strategic culture is undergoing a profound shift in emphasis away from exceptionalism and towards aspirations of global leadership. But India views China's rise from a position of growing confidence rather than insecurity, and shares few of Japan's historic idiosyncrasies about China. Instead, New Delhi has recalibrated its relationship with China over the past few

India views China's rise from a position of growing confidence rather than insecurity.

years to maximize the benefits for India's own goals of economic growth and expanded global leadership. This has meant shedding confrontational legacy issues from previous conflicts with China, most notably by reaching a bilateral border demarcation agreement over the contested but isolated Siachen Glacier, and granting Beijing a "strategic partnership"

(both in 2004). In the economic realm India has encouraged an expansion of trade with China, which has grown from a very low bilateral based of \$12 billion in Fiscal Year 2003 to a promising \$23 billion in Fiscal Year 2005⁷. India has also joined with China in multilateral cooperative efforts on energy development, including the U.S.-led Asia Pacific Partnership and a trilateral energy dialogue with China and Japan.

At the same time, India's traditional strategy of balancing China has deepened on several fronts. India continues to modernize its minimal deterrent with the recent test of the long-range Agni missile and has expanded naval operations eastward across the Indian Ocean, including the joint operations with the U.S., Australian, Japanese, and Singaporean navies, in response to the December 2005 tsunami. Diplomatically, India has accelerated its "Look East" policy with participation in the East Asia Summit in Kuala Lumpur in December 2005 and beefed-up strategic dialogue with Japan. India is also taking steps to counter Chinese influence in Southeast Asia, including work on road and rail lines through Burma and contracts with the Burmese government for export of natural gas (which were signed in March 2003 immediately after Beijing promised similar investment). Finally, New Delhi has quietly maintained stringent controls on Chinese foreign direct investment into India to prevent Chinese firms from displacing Indian workers or threatening indigenous hi-tech firms⁸.

India has also changed the context of its relationship with China by fundamentally transforming its relationship with the United States. While Beijing has sought stable ties with Washington under the strategy of peaceful development, India has chosen to move away from four decades of non-alignment to embrace a truly substantive strategic partnership with the United States – an option open to New Delhi and not Beijing because of shared values between the world's oldest and largest democracies. U.S. support, in turn, has catapulted India to a higher level of international influence including implicit recognition of India's nuclear weapons status through the civil nuclear cooperation agreement reached between President Bush and Prime Minister Singh in March 2006.

China's discomfort with India's sudden stardom is evident in Beijing's mobilization of international opposition to India's joint bid with Japan, Germany, and Brazil for UN Security Council membership in 2005. Beijing has also tried to quietly derail support for the U.S.-India civil nuclear agreement in the Nuclear Suppliers Group.

Despite China's increasingly open moves to counter Indian influence, it is unlikely that New Delhi will put its economic agenda at risk by returning to a tit-for-tat strategic competition with China. However, India will continue positioning itself to be the large democratic counterweight and alternative to China in Asia and can expect to enjoy a strong gravitational pull on other Asian powers like Japan, Singapore, and Australia.

KOREA

South Korea's diplomatic rapprochement and economic interdependence with China after normalization of relations in August 1992 have been so rapid that Seoul appears at first glance to be embarked on an irreversible path of bandwagoning with Beijing. The impression of a divergence from the United States and convergence with China is further reinforced by the complex sentiments of the current generation of Korean leadership towards the United States and Japan and the Roh government's preference for engagement of Pyongyang before denuclearization. The reality, of course, is far more complex.

In 2003, China became South Korea's largest trading partner and Beijing tried to leverage that relationship to expand bilateral cooperation to the political and strategic spheres. Chinese officials in late 2003 asked the South Korean foreign ministry to disband the U.S.-Japan-ROK Trilateral Coordination and Oversight Group (TCOG) in favor of a China-ROK coordination mechanism within the new Six Party Talks. Seoul refused at first, but after relations deteriorated with Japan over the disputed Tokdo or Takeshima islands and the Blue House became uncomfortable with the harder line of the U.S. and Japanese delegations in the trilateral meetings, the South Korean side stopped attending. In the same period South Korea took other opportunities to signal that it would distance itself from U.S. and Japanese strategies on China, including public resistance to U.S. requests for "strategic flexibility" for U.S. forces in Korea, and refusal to participate in the Proliferation Security Initiative or missile defense (although the ROK Navy does plan shared missile defense capabilities). Meanwhile, the Blue House has embraced a new doctrine promoting South Korea as the "balancer" in Northeast Asia and has encouraged the ROK Navy to focus on Japan as the most likely emerging threat after North Korea.

At the same time, however, there have been unmistakable signs of strategic tension between Seoul and Beijing just beneath the surface. In contrast to the complimentary nature of Sino-Japanese economic relations, South Korean industries – particularly steel and manufacturing – are warning that they face a direct threat from Chinese competition.⁹ In addition, while Seoul and Beijing may both share a preference for engagement over pressure on North Korea, South Koreans are growing increasingly anxious about China's dominant position in the North.¹⁰ South Korea and China are also divided over values, as became clear when Beijing refused Seoul's entreaties earlier in 2006 to

There have been unmistakable signs of strategic tension between Seoul and Beijing.

protect or return to Seoul a North Korean woman taking refuge in a South Korean school in China (Chinese authorities sent her back to North Korea and an uncertain fate). Finally, China and South Korea have clashed over their own history textbook issue, as Beijing has continued to inflame South Korean emotions by promoting the “patriotic” interpretation that Korea was part of China during the Koguryo period (37 BC to AD 668). It is this context that explains a recent poll by the Korean Institute for Defense Analysis in which 38 percent of South Koreans pointed to *China* as their biggest future security threat and not Japan (which trailed in the poll by 15 points).¹¹

Meanwhile, polling suggests that support for the U.S.-ROK alliance has been surprisingly resilient – if volatile – in spite of the friction between Seoul and Washington over North Korea policy. Moreover, the record of accomplishments in the alliance in recent years has been impressive: successful realignment of U.S. forces in Korea; dispatch of a brigade of South Korean troops to Iraq; and now negotiations on a bilateral free trade agreement that will be the most significant in Asia if successfully concluded. Despite the growing areas of resonance between the Chinese and South Korean governments’ views of North Korea, this is a record of concrete coordination that Beijing is unlikely to match in the foreseeable future.

SOUTHEAST ASIA

Like Korea, Southeast Asia has rapidly warmed to China over the past decade, particularly after Beijing’s decision not to revalue the renminbi during the 1997 financial crisis at a time when Washington and the IMF were demanding tough conditionality in exchange for help. Economic ties between China and Southeast Asia have accelerated since then to almost \$100 billion in annual

Southeast Asia has rapidly warmed to China.

trade in 2005, with ASEAN exports accounting for over \$60 billion of that. Building on this economic connection, China has expanded its political partnerships in the region, signing an ASEAN-China Strategic Partnership in 2003 under which Beijing endorsed the ASEAN Treaty of Amity and

Cooperation (including the principles of non-interference that Beijing has found so useful). China has also agreed to user-friendly free trade agreements with ASEAN and has sent its top diplomats to the region to consolidate Beijing’s soft power advantages (represented by a huge spike in Chinese language studies in the region). While Beijing has taken advantage of Washington’s necessary preoccupation with counterterrorism cooperation to expand its own access in the region, the biggest relative loser of influence has probably been Japan.

It is important to remember that Japan also enjoyed a period of rapidly expanded influence in Southeast Asia in the 1980s based on the appreciation of the yen and what was at the time considered highly effective Japanese economic diplomacy. In retrospect, it is apparent that Tokyo suffered from numerous weaknesses in its relations with the region. To some extent the same may be true of Beijing today. Despite the favorable trade balance for ASEAN members, Chinese industries compete more directly with leading ASEAN nations than even with Korean firms. Moreover, while few Southeast Asian defense ministers have been willing to echo Secretary of Defense Rumsfeld’s expression of concerns about the PLA military build-up, it has not escaped their attention that China is steadily expanding its blue water naval capabilities in directions that could negatively impact the region’s security. Even on the ideational question of non-interference in internal affairs, Southeast Asian leaders are increasingly finding themselves at odds with Beijing as the Chinese side

counteracts ASEAN efforts to pressure Burma on democracy and human rights (the most striking example was Chinese Foreign Minister Li Zhaoxing's sudden visit to cut deals with Rangoon only days after the rest of ASEAN had pressured the junta not to accept its turn as chair of the regional organization in July 2005). Indeed, in January of 2007, ASEAN leaders were presented with a new draft Charter by the organization's Eminent Persons Group that included language highlighting the preservation of human rights, democracy, and universal values as central to the organization's mission. Then on March 1, 2007, the ASEAN foreign ministers agreed to establish a mechanism to monitor human rights.¹²

Key Southeast Asian governments have also demonstrated a readiness to recalibrate their relationship with Washington in order to balance China when Beijing overplays its hand. One example occurred in late 2004 when Beijing convinced Cambodia to table a proposal within ASEAN for China to take the lead in hosting the 2007 East Asian Summit, including control of the participants and agenda. Malaysia, Thailand, Cambodia, Laos, and Burma all lined up behind the idea. To the alarm of the other members, ASEAN had suddenly gone from a buttress against great power influence to a conduit for China. Within months of China's move, Singapore accelerated completion of a Strategic Framework Agreement with the United States, Vietnam agreed to U.S. demands on religious freedom, paving the way for an historic summit meeting in Washington, and Indonesia took steps to ease the way for a resumption of bilateral cooperation with the U.S. military. That fall the seven ASEAN leaders in APEC met with President Bush to sign the U.S.-ASEAN Enhanced Partnership agreement to expand trade, political, and diplomatic cooperation. ASEAN has also reasserted its control over the timing, agenda, and participants for the East Asian Summit.

ASEAN leaders do not want rapid changes in the balance of power and influence in their neighborhood. Their answer is not less Chinese involvement in their region, since they are benefiting tremendously from China's economic growth, but rather more U.S., Japanese, and Indian presence to maintain a check on China and to preserve political space for themselves.

OTHER ACTORS

A final word is necessary on the other influential actors in the region, for whom China's rise also presents a complex array of challenges and opportunities in terms of their economies, security, and national identity. For Australians, China's growing influence initially fueled an academic and political debate about whether the nation's future lies with the new Asian order or alliance with the United States. However, Beijing's efforts to push an East Asian institutional architecture that excludes Australia, and a heavy-handed response to the defection of a Chinese diplomat in Canberra, have begun to sour the Australian view of China. In 2005, the Howard government also demonstrated that it is possible to negotiate a \$25 billion gas export deal with a resource-hungry China within weeks of establishing a Trilateral Security Dialogue with the United States and Japan. The Howard government clearly recognizes who is the demander in the relationship with China as well as the advantage of close strategic ties to the United States – and increasingly Japan. The opposition Labor Party sometimes criticizes the government for not taking China more seriously, but the core of Australia's strategy is supported by the leadership in both parties.

Taiwan's response to the rise of Chinese power has been difficult to explain. While Beijing has increased defense spending at officially announced rates of over 10 percent since 2001, the government in Taipei has responded with barely any increase at all in its own expenditures. At a time

when secure relationships with Washington and Tokyo are critical to dissuading China from using force, Taipei has antagonized both by unilaterally pushing towards *de jure* independence. And in response to Beijing's efforts to drive a wedge between the ruling and opposition camps on Taiwan, the leaders in both camps have engaged in mudslinging and impeachment procedures that only lead to further polarization. Taiwan's leaders are not taking these counterproductive actions because they are unaware of the rise of Chinese power but precisely because China's economic pull on Taiwan has led them to push even harder for formal separation from the mainland. The futility of this response has grown increasingly apparent to the Taiwanese people, however, and the ruling pan-Green camp has steadily moved away from independence themes while announcing plans for an increase in annual defense spending to three percent of GDP. Taiwan also still retains the ultimate trump card vis-à-vis Beijing – the fact of Taiwan's democracy itself.

With a population of only two million people sandwiched between China and Russia and an army the size of one Chinese division, Mongolia is practicing the most creative China policy in the region. Ulan Bator has dispatched its best forces abroad for peacekeeping and service in Iraq and Afghanistan and has announced that common democratic values have made the United States, Japan, and Europe its "third neighbors." In short, Mongolia is trying to use the entire world to balance China.

IMPLICATIONS FOR THE UNITED STATES

Asia still clearly views the United States as the indispensable power. China's rise has meant that every state in Asia wants more of the United States, not less. Most of the region has also demonstrated a readiness to tighten security cooperation with the United States in order to balance China when Beijing over-reaches. In addition, leading powers like Japan and India have demonstrated an

China's rise has meant that Asia wants more of the United States, not less.

appetite for promoting the values of democracy and rule of law that the United States represents. As a result, American ideals are growing in influence as democracy spreads steadily across the region.

At the same time, however, most Asian nations still view the United States with some trepidation. Our unparalleled national power, our transformational worldview, and their own high level of

dependence on us, all mean that the United States sometimes looks like an ogre as well. Even our closest allies will want to retain enough freedom of maneuver to position themselves to take advantage of China's economic boom and to avoid entrapment in U.S. strategy lest it move in the direction of either containment or abandonment. Moreover, while none of the region's powers wants to see Sino-U.S. confrontation, neither do they want a Sino-U.S. condominium that marginalizes their own influence.

The United States cannot shape China's choices without first shaping Asia's choices. However, Asia is not ready to line-up behind a China strategy made in America. We will therefore have to develop a differentiated strategy for engaging each of our partners on China. We will need to remain highly sensitive to their national interests and to each of their concerns about both entrapment and abandonment. We will need to seek out and emphasize the values we share with increasing numbers of Asian governments and societies so that they shape a regional agenda that advances our interests – we want democracy, governance, and the rule of law to become Asia's agenda, not a

purely American agenda to which Asia reacts. We will have to make it clear that the United States seeks stable and improving relations with Beijing, but not a bipolar condominium that reduces our allies' influence and grants China a veto over the regional agenda. We will need to increase investment in our own resources, training our citizens not only in Chinese, but also in Japanese, Korean, Mongolian, Thai, and Indonesian.

This task is not beyond the capabilities of the United States, nor is it inherently unhealthy for U.S.-China relations or contrary to Beijing's own long-term interests. However, it is a task that will require consistent attention and long-term commitment.

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DAY IV

CHINA'S RISE IN AMERICAN MILITARY STRATEGY

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No one, including the Chinese leaders themselves, knows where destiny will take China as a military power. Will China be friend or foe of the United States 20 years hence? The wrong American actions can *ensure* that China will become a foe, but the right American actions can only *increase the likelihood* that China will become a friend. America's actions are important but not fully determinant, since the answer to this question will also be influenced in important ways by the attitudes of China's younger generation, the policies of its future leaders, its internal development and stability, and the possibility of crises like one over Taiwan. There is no convincing way for Chinese leaders to persuade Americans of their "intentions" decades in the future. China's future intentions are not a *secret* they are keeping from us, they are a *mystery* to both sides.

In this strategic circumstance, the United States has no choice but to have a two-pronged policy. One prong is to *engage* China to encourage it to become a "responsible stakeholder" in the international community. The second is to *hedge* against a downside scenario of competitive or aggressive behavior by China. Americans are impatient and dislike ambiguity, so successive U.S. administrations have struggled to sustain public support for the needed two-pronged policy – a policy that to many, at first glance, can seem self-contradictory. But there is no reason for our policy to *be* self-contradictory. Determination to engage should not get in the way of prudent hedging, and excessive hedging should not create a self-fulfilling prophesy whereby treating China as an enemy contributes to making it an enemy. Hedging against a competitive China – but hedging prudently – is a key objective of American military strategy.

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Since the Chinese military leaders also do not know where destiny will carry the relationship, it follows that they, too, probably have a two-pronged strategy. Hedging is contagious. The Chinese will be preparing militarily for the downside scenario, and their hedging will look to the United States like the leading indicator of the very competitive behavior against which it is hedging. And so hedging can beget more hedging in a dangerous spiral. In the Cold War an analogous spiral was caused by ambiguous hedging and the assumption of worst-case scenarios by the United States and the U.S.S.R. This spiraling led to a dangerous and expensive nuclear arms race, ultimately resulting in more than 50,000 nuclear warheads being deployed.

To make things more complicated, both China and the United States have other strategic factors driving their military postures than the possibility of conflict with each other. For the United States, the responsibilities of world leadership recommend maintaining the qualitative superiority and quantitative sufficiency its forces now possess. The Department of Defense (DOD) will receive

China is building up its military and competing with the United States.

an appropriation in excess of \$500 billion (including supplementals) in Fiscal Year 2007 for a host of current missions and future contingencies, many completely unrelated to East Asia. China will be spending about 15 percent of this amount on its defense in 2006 (even correcting for hidden subsidies in the Chinese budget). In China's eyes, it has not yet built a military large and strong enough to be propor-

tionate to the large role it sees for itself in the world of the future. In addition to hedging over the long run against the United States, China weighs its military power in relation to the neighbors it seeks to deter and overbear: Japan, Russia, and India. So China would be building up its military to match its global ambitions and pursue its regional rivalries no matter how it estimates the future of the U.S.-China relationship.

To complicate things even further, there is one critical respect in which U.S. and Chinese forces are both already committed to direct, head-to-head military competition – over the Taiwan Strait contingency. The United States has a policy (written into law, the Taiwan Relations Act) to be prepared to defend Taiwan from Chinese invasion or coercion. It has an accompanying policy of opposing the pursuit of independence by Taiwan and of refraining from pushing for an early resolution of the overall issue of Taiwan's reunification with the mainland. Despite this policy's complexity, it has been sustained by all successive U.S. administrations since it was instituted by Richard Nixon. The U.S. military therefore correctly anticipates having the long-term mission of ensuring access to the Strait and achieving air and sea dominance there. China, for its part, will not renounce the use of force to prevent Taiwan independence. For the Chinese military, this means being able to intimidate, if not conquer, Taiwan. It also means being able to chase or scare away U.S. forces from the Strait by making naval and air operations there too hazardous. Given this semi-permanent situation, every day for the foreseeable future the U.S. and Chinese militaries will take each other's measure in the Strait and pursue competing military objectives – a miniature and localized but very real “arms race.”

For a mix of reasons, therefore – but undeniably – China is building up its military and competing with the United States. This should concern the United States, but what should we do? To borrow a phrase from U.S.-Soviet cold war military competition, “How much is enough?” for China? Secretary of Defense Donald Rumsfeld lays stress on Chinese openness and “transparency.” It is important for China's people, its neighbors, and the United States to know the size and shape of China's buildup, and the requirement that they be open about it might dissuade the Chinese from an excessive buildup. The most important form of transparency China could exhibit would be a true reckoning of its defense budget. But emphasizing transparency does not address the question of what would be “excessive.” Former Secretary of State Warren Christopher, when characterizing U.S. sanctions on Iran, was fond of saying that the United States should not sell Iran a Kleenex. In the same spirit, the United States would clearly prefer that China arm itself with only a bow and arrow. Between a bow and arrow and an all-out drive to be a military peer of the United States across all elements of military power, where will China end up? Where should it end up,

from the point of view of American interests? Said differently, what actions on China's part would compel a reaction on the part of the United States in its own military plans and programs? This paper addresses these important questions.

THE UNITED STATES IN CHINESE MILITARY STRATEGY

Any Chinese military officer will begin the story of Chinese strategy with history. China has, he will observe, a glorious ancient tradition of military art. Especially quoted will be Sun Zhi, who was to warcraft what Machiavelli was to statecraft – a master of strategy, subtlety, and deceit. But in more modern times, you will be told, China descended into military backwardness and weakness. First came the “century of humiliation” from the mid-19th century to the communist revolution, when China was preyed upon and picked apart by neighbors and distant colonizers. With the communist revolution in 1949, China could at last “stand up tall” in terms of sovereignty, but the military strategy propounded by Mao, however appropriate to the times, is regarded by today's Chinese military as decidedly backward. Mao gave the People's Liberation Army (PLA) a strategy of People's War. The strategy was aimed mostly at the Soviet Union and secondarily the United States. The idea was to fight these enemies on Chinese territory (no “power projection”), drawing invading armies deep into Chinese territory, enveloping them, and destroying them slowly in a protracted war of attrition. For such a People's War a mass conscript army spread all over the Chinese countryside was needed. Of course Mao fully understood that this army could also maintain communist party control over China's huge population.

When Deng Xiaoping replaced Mao Zedong, and especially when Jiang Zemin and Hu Jintao took over, the People's War legacy weighed oppressively on the PLA. The army was wastefully deployed across the vastness of China, entangled in local politics and very much entangled in local economies, had no power projection capability, and was technologically backward. Deng and his successors advocated new theories of “Local War” (versus total war) and “Rapid War, Rapid Resolution” (as opposed to war of attrition).³ Today's PLA officers are attempting to realize this vision.

To do so, they do not have all the resources they would like. The Chinese defense budget is probably somewhere in the neighborhood of \$50 to \$80 billion (when properly computed, which is itself a complicated exercise⁴), whereas the United States will spend about \$500 billion in Fiscal Year 2007. The Chinese defense budget, however, has been growing at more than 10 percent per annum for two decades – a higher rate than the growth of China's GDP, although lower than the growth rate of overall public spending. In the Chinese government budget, military spending competes with other pressing needs: a revolution of rising expectations in the population, a middle class as large as the U.S. population, regional and urban/rural inequality, an aging population (China's workforce will peak in 2015, and already the population is aging faster than it is growing rich), underdeveloped and bad-debt-burdened capital markets, and so on.

To bring their military out of perceived backwardness, the Chinese have a plan (described in their Defense White Paper⁵) that reads like the Pentagon's Quadrennial Defense Review (QDR) and was probably inspired by it. It describes the modernization trajectory for the PLA in terms of a “Revolution in Military Affairs with Chinese Characteristics.” It stresses the same themes as the QDR, although the Chinese concede they need to “leapfrog” generations to match America's state-of-the-art military capabilities.

- “Informationalization”: Regarding what the United States calls “command, control, communications, intelligences, reconnaissance, and surveillance (C4ISR)” the White Paper stresses satellite and airborne sensors, unmanned aerial vehicles, and information warfare.
- Jointness: The PLA, PLAN (PLA Navy), and PLAAF (PLA Air Force) are undertaking their own version of the U.S. Goldwater-Nichols reforms of the 1980s to bring the three military services, today quite separate and dominated by the PLA, into the age of combined arms operations.
- Personnel Reform: The PLA is still too large, deriving from its Maoist past, consisting of 2.3 million personnel on active duty, 800,000 reservists, and a People’s Armed Police (PAP) of 1.5 million. The White Paper calls for reduction in size and professionalization of the military.
- Business Practices Reform: In a Chinese version of the American “Revolution in Business Affairs,” the PLA is shedding its farms, businesses, and other deadweight features of a peasant army spread throughout the countryside.
- Training Standards and Exercises: China is trying to increase the readiness of at least selected units, train them intensively, and exercise realistically (including joint exercises with Russia and other nations).
- Defense R&D and Weapons Imports: China’s defense R&D system and military industry have the features of the dated State Owned Enterprises (SOEs), not today’s go-go commercial economy: backward, bureaucratic, and entrenched. While China strives to modernize its own defense industry, it is turning principally to Russia for advanced tactical aircraft, submarines, surface combatants, air defenses, anti-ship cruise missiles, and other systems that challenge U.S. forces in ways that Chinese-made weapons could not. The United States and Europe have an arms embargo against China dating from the Tiananmen incident in 1989.

The Chinese White Paper is more circumspect about the missions it envisions for its growing and modernizing force, but it is likely that internal discussion stresses these missions:

- Maintain strategic nuclear deterrence, using a sufficient force of intercontinental ballistic missiles (ICBMs) and submarine-launched ballistic missiles (SLBMs).
- Puncture American dominance where possible. China aims to exploit vulnerabilities in key American capabilities, using counter-space, counter-carrier, counter-air, and information warfare to block the U.S. military from dominating outright a military confrontation or achieving quick and easy victory, even if eventual U.S. victory is assured.
- Match or overbear China’s neighbors. Long before China can hope to match the United States, it can match or overbear its neighbors. China’s adjusted defense spending of \$50-\$80 billion is already comparable to Japan’s \$44 billion, Russia’s \$65 billion, and India’s \$24 billion. It compares easily with the European powers’ defense investments: the United Kingdom, with the most usable of Europe’s militaries, spends \$50 billion.
- Coerce Taiwan and counter U.S. intervention. This is a clear PLA objective sanctioned by the political leadership. The bilateral Taiwan-China balance in the Strait is clearly shifting in China’s favor as Taiwan’s spending for its own defense actually decreases. China does not have the amphibious and airborne forces required for an invasion of Taiwan at this time, and such an operation would be disastrous if U.S. air and naval forces came to Taiwan’s aid. Instead, China aims to intimidate Taiwan with short range ballistic missiles (SRBMs) (700

CSS-6 and CSS-7 missiles are deployed in the military district opposite Taiwan, and this force is growing every year) and/or cause Taiwan's economy to collapse by making it too hazardous for air or maritime commercial vehicles to come to the island (e.g., by sowing mines near Taiwan's harbors).

- Ensure internal stability and order. China's leaders, all of whom lived through the Cultural Revolution, fear internal disorder, perhaps above all "national security" threats. The number of incidents of public rioting and other disorders is growing – even in the statistics reported by the Chinese authorities.⁶ This is the predictable result of rapid and uneven economic change. China is not, however, an ethnic patchwork like the Soviet Union. There are only seven million Uighurs and five million Tibetans in China. The Chinese population overall is 92 percent Han Chinese.
- Secure resources. China is generally a resource-poor country. It is the world's second largest consumer of oil and its third largest importer, signifying a dependence on Middle Eastern and African oil that is uppermost in the minds of China's leaders.
- Reinforce territorial claims. China has settled most of its land border disputes with its neighbors, but it continues to contest ownership of the Senkaku, Spratley, and other islands. Periodic incidents between the PLA and the navies of the region are not strategically significant, but they have deep emotional resonance given the larger feelings of rivalry and historic grievances among the nations of East Asia.

These varied missions indicate that while competing with the United States might be China's most important objective in its military modernization, the PLA is in fact managing a portfolio of investments. China's leaders probably also harbor the goal of ultimately matching the United States in comprehensive military power. But they doubtless recognize that it would take decades, if ever, to achieve it.⁷ In the meantime, they have set themselves these other, more achievable, goals.

CHINA IN U.S. MILITARY STRATEGY

If China's military has a portfolio problem, America's is even more complex. U.S. force structure and investment is being pulled in five directions at once.

- Hedging against China. In terms of military investment, this mission emphasizes ultra-modern air and naval capabilities. It is the main budgetary rationale for advanced fighter aircraft, a new strategic bomber, new aircraft carriers and other surface combatants, stealthy unmanned aerial systems with long range and dwell time, nuclear attack submarines, and a host of C4ISR assets.
- The "Long War" against terrorism, especially Islamist extremism. This mission leads to a very different emphasis: special operations forces, intelligence, law enforcement, diplomacy, and homeland security.
- Stability operations and peacekeeping. Operations in Somalia, Bosnia, Kosovo, Iraq, Afghanistan and elsewhere in the past 15 years suggest that U.S. forces will be called upon to conduct them, notwithstanding the ambivalence of the public about such involvements. These missions require large ground forces with a wide range of capabilities, from combat to policing and economic reconstruction.

- Major theater war. The North Korea contingency and a range of contingencies in the Middle East could again require the capabilities for traditional warfare in two theaters simultaneously. This mission calls for the maintenance of a relatively large conventional force structure.
- Counterproliferation. Weapons of Mass Destruction (WMD) threats underscore the need for deterrent forces (nuclear and non-nuclear) of reasonable size and survivability, and for protective measures ranging from chemical suits to missile defenses.

None of these missions can be sacrificed to fund the others. All must be pursued simultaneously. The DOD must fund its portfolio, moreover, in the face of a looming budget crunch of huge proportions.

It might seem strange that the DOD could be facing a budget crisis when its baseline has increased from about \$300 billion pre-9/11 to about \$450 billion today, and when it is furthermore receiving supplementals for Iraq and Afghanistan of \$50 billion or more on top of the baseline. To

If China's military has a portfolio problem, America's is even more complex.

understand this, one must note, first, that the defense program has changed much less than the budget. To a remarkable degree, the 50 percent increase in the DOD baseline since 9/11 has gone to funding the program of record on 9/11 (i.e., the weapons that were already in the pipeline on 9/11). This program of record was already unrealistically budgeted before 9/11, and the great

majority of weapons systems end up costing much more than budgeted. Additionally, the exploding cost of health and other benefits for active duty and retired military is devouring a larger and larger chunk of the Pentagon budget, as is the high operations tempo and intensive training schedule. The growth in the Personnel and Operations and Maintenance portions of the budget squeezes out the investment portion (Research, Development, Test, and Evaluation (RDT&E) and Procurement) that is most relevant to the China hedging mission. Perversely, the supplementals will contribute to the crunch in two ways. First, it appears that there will be costs to “reset” the force (e.g., repair or replace vehicles used more intensively than originally planned) not captured by the supplementals that will need to be paid out of the baseline budget. Second, some of the new and most innovative programs (i.e., programs that were not part of the program of record on 9/11) are funded in the supplementals and will have to fight their way into the baseline budget when the supplementals dry up. Many will not win this daunting battle against older and more entrenched programs, hindering the overall process of transformation. Meanwhile, the ongoing operations in Iraq and Afghanistan have already dangerously overstretched the U.S. Army especially.

A mixture of poor management, the stresses of prolonged wars in several places, and chronic cost growth is creating a perfect storm in defense management that will place limits on the resources available to hedge against an aggressive China. Whatever the resources Congress makes available to DOD in coming years, it will need to find a balance among missions that includes a prudent China hedge.

HOW MUCH IS ENOUGH FOR CHINA?

The United States and most states in the region might prefer to see China remain stuck in the Maoist People's War tradition. But the reality is that China will be developing its military power

in parallel with its growing economic and political power, and seeking to fulfill the portfolio of missions dictated by its strategy. For U.S. purposes, Chinese military developments can be put into three categories:

First, are efforts aimed mostly at increasing comprehensive military power and putting the Maoist legacy behind? These developments are predicted to occur with high probability. They have serious consequences for the U.S. military, for U.S. policy in the region, and for other regional states. Although they are not welcome developments, they are broadly consistent with the growing power of a “responsible stakeholder.” Some of them, in fact, would in principle allow China to contribute to military missions like peacekeeping and counterterrorism as a global stakeholder if it chose to, much as NATO and sometimes Russia do. Others will alter the military landscape of East Asia profoundly. Developments in this category are as follows.

- Slow growth in the ability to apply modern and comprehensive military power locally and regionally, including limited power projection capability. Modernization of tactical air (Su-27 and Su-30 fighters), airborne warning and control, mid-air refueling (IL-76 and IL-78 mid-air refuelers), airlift, more capable and more numerous surface combatants (although for the foreseeable future far less of a “blue-water” navy than the U.S. Navy), perhaps acquisition of a fledgling carrier force, “informationalization” and jointness will slowly bring China from a continental power to a regional power, although not yet a global power.
- Modernization of China’s “countervalue” strategic nuclear deterrent. Newer, mobile DF-31s and DF-31As, solid-fueled ICBMs, and JL-2 SLBMs without a large increase in overall numbers of warheads (tens rather than hundreds, with no MIRV’d missiles) will not alter significantly the long-standing Chinese strategic nuclear threat to the United States.
- Shift in local balances. Japan, Russia, India, Vietnam, and others will soon face a Chinese military much more formidable than in the past, and in many cases a match for or better than their own.
- Shift in the bilateral balance between China and Taiwan in China’s favor. The sheer weight of China’s future military investments will inexorably shift the balance between China and Taiwan in China’s favor. Moreover, Taiwan is not spending enough to counter the growing Chinese military effort, and specifically not the missile threat and blockade threat from China. The invasion threat is largely countered by Taiwan’s island geography more than by any specific investments of Taiwan’s military. Taiwan is spending less as China is spending more. The shift in the military balance is mirrored economically by the fact that Taiwan, which was once thought to be the gateway through which foreign investment would flow into China, is being bypassed in favor of China; and politically by the weakness of Chen Shui-bien’s Democratic Progressive Party (DPP) and the Pan Blue alliance’s flirtation with the mainland. As Taiwan’s ability to defend itself declines, its dependence on the United States naturally increases.
- Possible development of capabilities for international peacekeeping, stability operations, counterterrorism, and counterproliferation. As Chinese forces become more deployable, more effective, and more experienced they can also become more useful to the efforts of leading states to counter state and non-state threats to international security, should China choose the “responsible stakeholder” model.

Second, are efforts devoted specifically to countering selected areas of U.S. military advantage or intimidating Taiwan? These efforts are also almost certain to occur. They cannot be regarded as natural ingredients of a post-Maoist general upgrade of China's military power: they are specifically aimed at U.S. forces and fueled especially by the Taiwan contingency. U.S. appeals to Chinese "transparency" will cast a spotlight on these developments. The United States should continue to urge restraint in counter-Taiwan capabilities, since threatening Taiwan is likely to drive its population further away from the mainland. However, Chinese efforts to undermine the main sources of U.S. operational supremacy will require specific U.S. investments to counter them. These investments are in line with the Pentagon's budgetary plans and need to be accommodated within future budgets. They constitute the near- and medium-term hedges required by the two-pronged U.S. strategy towards China.

Efforts devoted specifically to countering selected areas of U.S. military advantage or intimidating Taiwan are almost certain to occur.

- Counter-information capabilities. China is stressing anti-satellite and information warfare capabilities specifically designed to deny U.S. forces the C4ISR that is their trademark. Reacting to this trend will require, for example, greater investment in satellite defense (through maneuvering, redundancy, and other means).
- Counter-carrier capabilities. China is trying to be able to first locate, and then threaten, U.S. carriers operating in nearby waters, especially the Taiwan Strait through space and airborne long-range ocean surveillance, quiet diesel submarines, and sophisticated anti-ship cruise missiles procured from Russia.
- Counter-air upgrades. China is buying modern integrated air defenses (including the Russian S-300) to attempt to prevent the United States from gaining air dominance in the Strait or China itself.
- Green-water, if not fully blue-water, navy. China is slowly buying the vessels and gaining the experience to patrol its trade routes, show the Chinese flag, and make port calls or gain basing (e.g., in Pakistan) well beyond its shores.
- Counter-Taiwan capabilities. China is fielding more numerous and accurate ballistic missiles, drone aircraft, mine-laying craft, diesel submarines, and other capabilities that are clearly aimed at the Taiwan contingency rather than general growth of comprehensive military power.

Third, are Chinese political and military developments that are not occurring now but, if they occurred, would dramatically change the nature of the hedge needed by the United States? These developments would reveal Chinese intentions, and ultimately lead to Chinese capabilities, that are inconsistent with the power growth of a "responsible stakeholder" or the competition inherent in the ever-present Taiwan scenario. They would suggest all-out competition and "cold war."

- Irredentist rhetoric or claims, and aggressive rhetoric about "enemies" like Japan.
- Hypernationalism among Chinese youth, "standing up proud."
- Putting defense spending first in the Chinese government's budget. While Chinese defense

spending is larger than it has been in the past or that the United States or its neighbors would wish, it is still only about two percent of GDP and 10 percent of government spending. A crash spending effort at the expense of economic objectives would signal a major change in Chinese intentions and, in time, capabilities.

- A crash program to obtain the amphibious and airborne forces to invade Taiwan.
- Offensive biological or chemical weapons programs.
- An attempt to match or exceed the U.S. strategic nuclear deterrent force in overall numbers, or changing Chinese nuclear policy from no-first-use minimum deterrent to first-use or counterforce.
- Major new Chinese military alliances or foreign basing of Chinese forces.
- Large expansion in scale and scope of weapons purchases from Russia. These purchases today, while of high-end items China cannot make for itself, total only about \$2 billion per year.

CONCLUSION: DOS AND DON'TS OF HEDGING

U. S. strategy must hedge appropriately by responding to the Chinese military developments in categories one and two, and be prepared to respond in the long term to the developments in category three. The hedging must be done in a way that effectively counters these developments, does not contribute further or unnecessarily to the Chinese buildup, is consistent with the “engagement” part of U.S. strategy towards China, and is affordable within a constrained DOD budget with a portfolio of investments.

Recommendations for responsible hedging can be divided into “Dos” and “Don'ts.”

Do

- Continue to invest broadly in future transformational U.S. military capabilities in a portfolio approach that gives appropriate emphasis to highly advanced aerospace and maritime forces as well as to the ground and special forces needed for other near-term missions.
- Continue to improve the intensity and quality of intelligence collection and analysis of the Chinese military.
- Maintain and expand U.S. alliances in Asia, to include preserving the alliances with Japan, South Korea, and Australia, and pursuing deeper military partnerships with the Philippines, Singapore, India, and possibly Vietnam.
- Maintain and expand U.S. military “presence” in the region. It is particularly important to shore up the U.S.-ROK alliance, which has declined precipitously under Presidents Roh and Bush. The U.S.-ROK alliance is important for deterring North Korea, but beyond that it is a vital foothold for the overall U.S. military presence in the region in the long run. It will be easier for Japanese public opinion to continue to support the U.S. presence in Japan if we have forces in the ROK. The U.S. air and naval buildup on Guam is also an important contribution to U.S. presence in the region.
- Maintain the commitment to have the capability to defend Taiwan from Chinese invasion or military coercion.

- Conduct military-to-military activities. Military-to-military exchange is often thought to be an instrument of the engagement prong of the two-pronged strategy, since it engages an important constituency, the PLA, in U.S.-China relations and in the “responsible stakeholder” direction. But it is also an important instrument of hedging, because if there are crises or a period of tension and competition, miscalculations can be avoided. Reciprocity in military-to-military activities is important, but it need not be exactly symmetric. “Value-based reciprocity,” where each side obtains equal benefits, should be the metric that guides the military exchanges. Given the Chinese misunderstandings surrounding the 1999 Belgrade Embassy bombing and the 2001 Hainan mid-air collision, one useful theme of military contacts would be crisis management. Additionally, the talks between the U.S. Commander of Strategic Command (STRATCOM) and the head of the Chinese Second Artillery recently agreed to are valuable. However, the STRATCOM has a broad range of strategic responsibilities that the Second Artillery (which is centered on nuclear deterrent forces) does not, so the pairing is likely to devolve to a discussion of nuclear forces and space forces. STRATCOM should be careful not to allow these talks to replicate U.S.-USSR strategic nuclear discussions of the late Cold War. Those talks took place in the context of a cold war that is not present (or desirable) between the United States and China. They also reflected a strategic nuclear parity that again is neither present nor desirable in the contemporary U.S.-China case.
- Expand military-to-military activities to anticipate joint action where doing so is in both countries’ interest. Joint action could include search-and-rescue, counter-terrorism, counter-piracy, counter-narcotics, counter-people smuggling, humanitarian relief, noncombatant evacuation, and peacekeeping.
- Continue to oppose the lifting of the post-Tiananmen arms sales embargo by the European Union.

Don’t

- Attempt to create an encircling anti-Chinese alliance. Most of the potential counterweights to China have important bilateral relationships with China, including economic relations. They have two-pronged strategies of their own. They will not join in a “hedge-only” strategy. Attempts to create such an alliance will fail, and they will make it more likely that China will end up an enemy.
- Change U.S. policy towards Taiwan, which for decades has required a capability to defend Taiwan but not a commitment to use that capability, into a new defensive alliance committing the United States to Taiwan’s defense no matter what role Taiwan’s government has in provoking a conflict. Also, oppose any effort by Taiwan to obtain an independent offensive deterrent, especially nuclear weapons.
- Attempt to neutralize China’s nuclear deterrent with counterforce or missile defense. Such an effort is likely to backfire by causing China to build a larger nuclear force than it otherwise would, without achieving comprehensive or assured protection of the United States from a Chinese nuclear strike.
- Seek to deny China access to resources like oil that it needs for its economic development by non-market methods, while pressuring China to do likewise.

ENDNOTES

- 1 The authors are grateful to Jennifer Bulkeley, Ph.D. candidate at Harvard's Kennedy School of Government, for her research assistance and insights in preparation of this paper.
- 2 A research collaboration of Harvard and Stanford Universities, the Preventive Defense Project's work on U.S.-China relations is supported in part by the Carnegie Corporation of New York and the John D. and Catherine T. MacArthur Foundation.
- 3 See, for example, Bruzdinski, Jason E., "Striving for Rapid War, Rapid Resolution While Preparing for Protracted Struggle: China's Military Transformation for the New Era," Washington, DC: The MITRE Corporation (forthcoming), 2006.
- 4 The official Chinese defense budget, unlike the U.S. DOD budget, excludes key categories like R&D, the People's Armed Police, foreign purchases and sales of arms, local subsidies to PLA units in the countryside, and other items. After establishing comparable categories, the calculation is further complicated by the fact that costs of comparable items in the U.S. and Chinese economies are not the same. A soldier, for example, is drafted and given little in the way of benefits in the PLA; an American soldier is recruited and benefits are provided for his or her family in a relatively generous fashion.
- 5 Information Office of the State Council of the People's Republic of China, "China's National Defense White Paper," December 27, 2004, <http://english.peopledaily.com.cn/whitepaper/defense2004/defense2004.html>.
- 6 The Ministry of Public Security reported 74,000 "mass incidents" in 2004, a huge number even in a vast country like China. Susan V. Lawrence, "China's Internal Stability: Implications for U.S. Policy," Paper presented to the Aspen Institute's Eighth Conference on *U.S.-China Relations*, April 9-15, 2006.
- 7 The Council on Foreign Relations Task Force on Chinese Military Power concluded that China was 20 years behind the United States in terms of overall military technology and capability, and that the balance would remain "decisively in America's favor" both regionally and globally for the next 20 years. *Chinese Military Power*, Report of an Independent Task Force Sponsored by the Council on Foreign Relations, Harold Brown, Chair and Joseph W. Prueher, Vice Chair, 2003.

Constructing Strategies:
Possible Cooperation or
Inevitable Conflict

DAY IV

THE CASE FOR LONG-TERM STABILIZATION OF U.S.-CHINA RELATIONS

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SHAPING A CONSTRUCTIVE FUTURE

There are six reasons to be relatively optimistic about the long-term future of the U.S.-China relationship.

First, every President since Richard Nixon has run for office at least in part on the argument that his predecessor had been too soft on China. Upon taking office, each has tried either initially to downgrade the attention given to U.S.-China relations or to toughen America's stance. After a period of time, each has concluded that it does not serve America's vital national interests to worsen ties with Beijing. The substance of those ties has evolved greatly over this period, but this fundamental Presidential pattern has held true across both political parties and even in the presidencies of the most conservative Republicans. This suggests that those most responsible for understanding the full array of American national interests consistently conclude that those interests are well served by seeking to engage China where possible. This bodes well for the future U.S.-China relationship.

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Second, the current U.S.-China relationship is not fragile. Indeed, it has become extraordinarily wide ranging, complex, and deeply embedded in the political and economic systems of both societies.

Structurally, the financial, economic, and trade relationship is the most well-developed leg of our current bilateral engagement. It has produced a situation of such deep interdependence that only a very traumatic crisis could significantly change this in the short run. However, such disruption would palpably affect the standards of living in both countries. Despite well-known frictions, therefore, neither side is prepared to damage itself by taking steps to fundamentally disentangle this economic interdependence. China has shown, moreover, that economic cooperation with the United States is sufficiently important to warrant serious concessions when necessary to keep this part of our relationship in reasonably good working order.

The existing U.S.-China engagement extends far beyond classic foreign policy and economic spheres. Indeed, almost every major agency in the U.S. government has serious programs and frequent contacts with its Chinese counterpart. This includes such bodies as the Department of

Education, Housing and Urban Development, the Department of Energy, the Center for Disease Control, the Environmental Protection Agency, and so forth.

In short, the overall U.S.-China relationship is mature: even very significant problems in any one issue area will not disrupt the entire relationship, and a very solid base already exists for future cooperative efforts. Considerable interests in each country have gelled around the specific forms of engagement that the two countries have developed.

Third, China's fundamental strategic plans anticipate having its foreign policy primarily serve its own domestic development over the coming 15 to 20 years. Beijing terms this a period of "strategic opportunity" in which to construct a "relatively well off society."

China's last 200 years of history highlight the depth of feeling about creating a healthy society, strong and modern economy, and high capacity political system as the premier national goals. China in the early 19th century arguably had the world's largest economy, most vibrant commerce, and highest quality civil service, along with an extraordinarily well integrated society. All of these

were lost because pressures from the industrializing West and Japan changed the classic dynastic cycle (which produced changes of rulers without changes of system) into a fundamental collapse of the system itself and, with it, of China's security and confidence.

For the first time since the mid-1800s, China's government and people sense that they are on a trajectory to regain the relative stature and well-being that the repercussions of the Western industrial revolution had cost them.

Americans are shaping their China policy in the context of major uncertainties and disagreements about fundamentals.

This confidence has come only after decades of internal struggle and conflict over finding the strategy that would mend the country's wounds. It explains why, despite myriad serious problems, independent public opinion polls in recent years have found the Chinese to be more optimistic about their future than are the citizens of any other major country.

Fortunately, China (unlike Japan) decided years ago to pursue this goal by adopting a relatively open domestic economic system with very extensive ties to the international economic arena. China (unlike India) has determined that its future lies in its ability to adapt rapidly to the demands of globalization. While arguments about tactics inevitably remain, there is now a sense in the country that China has at last found the right fundamental strategy, and this strategy centers around creating a modern, technologically dynamic economy. The commitments to domestic economic development and to a basic strategy of capitalizing on globalization are therefore very deep-rooted and unlikely to change for any reason short of catastrophe.

This fundamental strategy requires supporting a relatively open international economic system, maintaining stability around China's borders, and sustaining workable relationships with the other major economic and military powers. China has encapsulated this situation in its proclamation that it is pursuing a path of "peaceful development." Tellingly, the original catch phrase discussed in Beijing was "peaceful rise," but top leaders felt putting China's "rise" to the fore might seem too threatening to others. They therefore opted for "peaceful development."

Regardless of the slogan, the core message remains the same: China can achieve its place in the

sun in a way that should not pose a threat to the vital interests of others and, unlike powers that “rose” in the 19th and 20th centuries, will not seek to achieve its goals through military force. It has especially strong interests, given this strategy, in maintaining constructive relations with the most powerful economic, military, and political power in the world, the United States. Whether this is achievable is hotly debated in both China and the United States.

Fourth, long-term U.S. interests are compatible with China’s development requirements, and China’s deeply-embedded goal set should therefore increase the potential for constructive U.S.-China engagement over the coming decades. Put succinctly, over the coming several decades the United States has major national interests that are best met if China:

- Is relatively successful and stable: If China becomes unstable and/or unable to meet its people’s basic needs, the international community will have to cope with problems ranging from a paradigm shift in levels of illegal migration and transnational crime, to potentially loose nukes and all the problems a continental-sized failed state can present.
- Supports and participates in an open and rule-based global economic system: Should China tilt fundamentally toward mercantilism and intellectual property piracy, it will impose increasing harm on the international economic system from which the United States derives such enormous benefit.
- Accepts and implements global norms on such key issues as the environment: China has already become second only to the United States as a contributor to global warming, and its environmental insults threaten not only its neighbors to its east but also those across the Pacific. Especially given that India appears to have entered a serious economic growth trajectory, it is in America’s vital interest that China adopts approaches and technologies that limit the environmental consequences of its own continued development.
- Welcomes and strengthens multilateral cooperation that includes U.S. participation to address traditional and nontraditional security threats: Regional groupings are playing an increasing role in global affairs. Asia is now and will remain for decades the most dynamic and important region of the world. China’s attitude toward regional multilateral initiatives around its periphery and toward U.S. participation in them will therefore prove very important for U.S. interests throughout Asia.
- Trusts U.S. intentions sufficiently to view America as a long-term constructive partner, whose interests will not always match those of China: All of the above hinges in significant part on the degree of China’s trust in U.S. intentions toward China going forward.

Put simply, every significant deviation from the above desired set of outcomes increases long-term costs and decreases long-term security and well-being for the United States.

Sixth, America’s friends and allies, especially those in Asia, want the United States to avoid a deeply antagonistic relationship with China. They see Sino-U.S. antagonism as decreasing regional stability, undercutting their leverage on a regionally integrated manufacturing system for producing products primarily for export to North America and Europe, and potentially increasing domestic tensions between their own ethnic Chinese and other citizens. Despite some natural variation country-by-country, all want the United States deeply and constructively engaged in Asia, and see this type of engagement as necessarily including building bridges of cooperation with China even as America’s presence and capabilities place inevitable constraints on China’s capabilities. As China’s weight in the region grows, this fundamental regional sentiment is likely to increase.

The above six factors highlight how serious the forces in favor of long-term constructive U.S.-China engagement are despite well-known areas of specific friction. Such constructive engagement meets the fundamental national interests of both countries, and successive leaderships of both sides have embraced this view despite massive changes in the international context of U.S.-China relations over the past 35 years. Constructive U.S.-China relations are also seen by other Asian countries as key to their own future development and well-being.

OPTIMISM IS NOT WARRANTED

Even in view of the above factors, however, too much can go wrong in the coming years to warrant optimism about the future of U.S.-China relations. Indeed, on balance, left to the natural course of events, U.S.-China relations are more likely to sink into confrontation and antagonism rather than enhance constructive engagement. Given the importance of the relationship and the extent their fundamental interests are compatible, why should mutual antagonism be regarded as the more likely natural outcome?

First, there are always unanticipated developments that could plunge the relationship into a long-term, downward spiral. The list of potentially disruptive events is unfortunately long and not very improbable. The types of issues include the following.

- Cross-Strait military conflict that draws in the United States and results in a major U.S.-China war. Cross-Strait relations have stabilized considerably over the past two years, and Beijing has put into place a policy that seeks to deter Taiwan's independence for many years to come rather than to force its unification with the Mainland. Still, there is very little mutual trust and understanding across the Strait. The most likely path to cross-Strait conflict is miscalculation. Should such conflict begin, the chances of American military participation are high, and once U.S. and PRC forces engage each other in hostilities, the likelihood of serious escalation is higher still.
- A crisis in Northeast Asia that goes seriously awry. Sino-Japanese diplomatic relations are poor and mutual threat perceptions have grown. Both Japan and China are rapidly changing their roles in Asia, and for the first time must figure out how to deal with each other at a time when both are strong and robust. A major crisis could well produce fundamental damage to U.S.-China relations and implicate America in the Japanese foreign policy agenda to a greater extent than might otherwise be wise. System collapse in North Korea could also lead to serious trouble, potentially producing not only chaos but also civil war in the North, with U.S. and Chinese forces drawn into a deadly and fluid situation. The outcome could produce entirely new levels of stress and division in U.S.-China relations and Northeast Asia more generally.
- Large-scale political unrest in China, perhaps growing out of a financial or environmental crisis. If the government reasserts control, in such circumstances it is likely to do so through violent means. Given current social strains, the scale of unrest and of the resulting repression would likely dwarf those of 1989 (when demonstrators were primarily intellectuals). China is and will for the coming two decades undergo four simultaneous, tension-inducing transitions at unprecedented speed and scale: urbanization, marketization, privatization, and globalization. The underlying strains are inevitably system-wide, deep, and pervasive. Massive

breakdown followed by large scale repression could make constructive engagement with China politically unsustainable in the United States.

All three of the above types of problems would likely arise against Beijing's preferences, but each could put U.S.-China relations into a steep downward spiral.

Second, America must shape its China policy without knowing with confidence the answers to crucial questions about the coming one to two decades. These are as follows.

- What kind of China should America place its bets on? One whose domestic system will become more liberal and capable; more despotic and capable; more corrupt and unfocused; or more unstable and chaotic? There is no major country in the world for which the range of perfectly feasible domestic outcomes over the coming 15 years is wider than is the case for China. Many American arguments about how to deal with China in fact reflect underlying disagreements among the disputants over just what type of China we will be dealing with, and over America's capacity to shape that outcome.
- Will the PRC's goals vis-à-vis the United States in Asia and beyond be to work with or to undercut American power? As argued above, China currently is pursuing a development path that assumes an ongoing ability to work with the United States. However, to the extent that Beijing sees America's long-term intentions toward the PRC as threatening, it will naturally seek to encourage counterweights to American power and freedom of action in the region. In this context, if Washington's core objective is to preserve a situation in which America has such absolute global and Asian regional superiority that no other country will try to limit U.S. power or prerogatives, China will view this as so fundamentally threatening that growing friction amidst attempts to limit American latitude is virtually inevitable. If America's national goal is, more modestly, to protect the prosperity and well being of the U.S. populace, there should be ample room for mutually beneficial cooperation. On such issues, words matter, and some of the wording in the 2006 *Quadrennial Defense Review* is thus potentially both important and unfortunate.
- Will America be able to politically manage the domestic changes (in education, social safety net, etc.) that will be required in order to remain competitive in a world in which China is playing an increasing role? The United States has for the last several decades provided China with ready advice on how to transition to a market economy and become more effectively engaged in the international economic arena. However, the China challenge has been recently seen as requiring serious adjustments in the domestic social contract and key institutions in the United States, if America is to retain its global competitive capabilities and fundamental well-being. This new reality is attaching China policy to an impressive array of very sensitive domestic issues on which there is no consensus, which is already making it difficult for Washington to sustain a policy of constructive engagement.

U.S.-China relations are more likely to lead to confrontation and antagonism rather than constructive engagement.

In sum, Americans are shaping their China policy in the context of major uncertainties and disagreements about fundamentals. In this situation, arguments for constructive engagement are seen by some serious thinkers as naively optimistic.

Third, Beijing has its own debates about the potential for long-term constructive relations with the United States. Most policy makers in China are relatively optimistic about the near term future of U.S.-China relations. In contrast, when the issue shifts to whether the United States will ever permit peaceful unification of Taiwan with the Mainland, a large number of Chinese believe the answer is no. They think that the United States will always seek to keep Taiwan separate so as to force Beijing to expend time and resources on this issue and to prevent China from ever realizing its full potential in terms of comprehensive national strength. Many Chinese policy makers also believe that U.S. foreign policy thinking is so locked into zero sum calculations that America will inevitably seek ways to contain China's development and its legitimate opportunities and aspirations. In short, pro-engagement leaders in Beijing must contend with the same uncertainties about the longer-term future and the same accusations of naïveté that bedevil their Washington counterparts.

THE PROBLEM OF MISTRUST

Remarkably comparable debates now rile policy in both Beijing and Washington. In each case, the argument is about how likely the other will be the biggest threat to national goals within two decades. Nobody can say with confidence that the other country *cannot* become the biggest threat to core national goals.

The “inevitable threat” protagonists adduce realpolitik arguments about the rise of a challenger to the global hegemon to posit inevitable antagonism and argue for measures to limit the other's potential power and latitude. The “possible threat” protagonists argue that astute diplomacy and concerted efforts to build constructive ties can lead to mutual advantage.

The key issue in both cases is an assessment of the ultimate *intentions* of the other country. The “inevitable threat” protagonists advocate military and other measures that essentially signal to the other side that a long-term constructive relationship is beyond reach. The hardliners on both sides, therefore, strengthen each other, as each points to the rhetoric and policies of their counterparts. In this way, advocates of this position can create self-fulfilling prophecies, promoting policies to deal with a threat that in turn induce threatening behavior that was the basis for the policy advocacy in the first place. “Possible threat” protagonists tend more to point to the types of long-term interests noted above to say that attentive diplomacy and creative policy can produce an outcome much closer to a win-win situation.

To further complicate things, militaries are professionally required to make fairly pessimistic judgments about the long-term future and to invest in developing the pertinent capabilities to assure security. The relevant timeframe for decisions on major new weapons systems is often 15 to 20 years. These military investments themselves then become grist for the mill for pessimists about the chances of long-term constructive U.S.-China engagement.

The unsurprising result of the above facts is that, despite the deep, wide ranging, complex, and relatively interdependent relationship that now exists between the United States and China, mutual distrust concerning long-term intentions appears to have grown in recent years. A substantial body of elite opinion in China argues that the United States simply will not allow China to become a country of real wealth and international gravitas, even if China seeks to play by the rules and allow for

extensive cooperation. An equally substantial body of opinion in the United States cannot believe that China will not use its increasing strength to challenge America's interests, compete for resources in a zero sum struggle, and try to supplant it in the dynamic Asian region. This mutual distrust about long-term intentions inevitably strengthens those who argue in each country that eventual antagonism is unavoidable and that it is therefore necessary to begin preparing for that eventuality.

This type of mindset makes it more difficult to perceive common interests and interpret efforts to establish trust. It even affects our understanding of core Chinese expressions that define their basic strategy. For example, Deng Xiaoping's admonition that China should behave modestly and not take the lead internationally was misinterpreted in a *Foreign Affairs* article and has ever since been regarded in the United States as calling for China to "hide its capabilities until it is ready to strike" – i.e., as a strategy of deception and potential aggression rather than one of simple caution.

STRATEGIC POINTS FOR GOING FORWARD

Both sides obviously will hedge against uncertainties even as they seek to broaden constructive engagement. The issue is how to prevent the hedges from contributing to mutual distrust so that they create a self-fulfilling prophecy of mutual antagonism. Part of the answer lies in the classic dictum, "Do no harm." That is, each side should take care to avoid the types of rhetoric and symbolic moves that signal deep pessimism about the long-term relationship. The oil sector provides a good current example of both the nature of the problem and the types of initiative that can be helpful in dealing with it effectively.

The PRC and the United States share major common interests in the oil sector. Both are domestic producers but are now, and will be for at least the coming few decades, the largest oil importers in the world. Both, therefore, have tremendous interests in bolstering the leverage of oil importers over oil exporters, increasing supply security, and moderating price volatility. Moreover, each will benefit mightily if both can achieve greater energy efficiency and reduce the environmental costs of their energy use. With all these shared interests, the countries should on most international oil issues find themselves on the same side of the table.

In reality, though, oil imports have become a sharply divisive issue, increasing threat perceptions and long-term distrust on each side. America accuses China of seeking to "take oil off the market" for China's exclusive use, through acquisition of equity oil (i.e., buying ownership of oil that is still in the ground). It also points to the reality that much of the equity oil that China has purchased is in countries governed by bad actors, concluding that China's oil interests are being pursued in a way that is completely counter to America's interests in oil accessibility and international security.

This critique is accurate in only minor degrees and misses the underlying realities. China purchases oil mostly from bad actors because its oil companies are not sufficiently competitive (in business acumen, financial skills, or technology) with the Western oil majors. Almost wherever the oil majors compete, therefore, the Chinese are not seriously in the game, and are limited to relatively marginal fields or to fields in countries where Western oil majors are barred by their own governments – such as Iran and Sudan. Even then, equity oil abroad equals in volume just 15 per-

The PRC and the United States share major common interests in the oil sector.

cent of the oil Chinese companies imported in 2005, and of that only a small percentage was actually shipped back to China (the rest was sold in the international oil markets).

Some Chinese equity purchases abroad are driven primarily by price considerations, and these amount to rational investments (Western majors each year acquire far more equity oil for the same reason). Others, though, appear to be driven by concerns over security of supply. These amount to largely irrational investments, as that oil must still be delivered over long and highly vulnerable supply routes to the PRC. Regardless of China's rationale, a more sophisticated understanding of oil markets would lead to the conclusion that China's efforts are actually increasing the oil available on those markets (it is pumping oil that otherwise would be untouched and thus freeing up the oil that it would otherwise have consumed from the international markets).

In sum, both the United States and China are bringing incorrect analytical lenses to the oil situation. China mistakes equity oil for secure oil, and thus does not appreciate the reality that much greater supply security can be obtained by becoming a sophisticated contractor in the international oil markets. The United States confuses Chinese equity oil with oil "taken off the market" and fails to appreciate the extent to which investments in rogue states are forced on China by the superior capabilities of Western companies. In this context, America's denial of CNOOC's effort to purchase UNOCAL in 2005, based on utterly wrong allegations about every aspect of Beijing's intentions, sent a strong signal to Beijing that reinforced its underlying fear that over the long term America seeks to deny China access to vitally needed oil. China imported 40 percent of its oil consumption in 2004, and consensus forecasts put that figure at 70 percent as of 2020.

To put this issue on a more constructive track, the United States should consider taking steps that would both make sense in terms of America's long-term interests and signal to China that Washington anticipates and encourages long-term cooperation with the PRC in the oil sector. Two initiatives highlight what the United States can do in terms of engaging China with multilateral regimes to assure more stable and secure oil markets in the future. Each, moreover, would require a significant Chinese response, thus giving Beijing an opportunity to demonstrate its equal desires for long-term cooperation.

First, the G-8 meeting this summer has energy at the top of its agenda. It makes little sense for the major powers to sit down to discuss global energy issues without the participation of the world's second biggest energy consumer. The United States can encourage the other members of the G-8 to reconceptualize that body so that it is seen as a grouping of the governments of the world's most important economies. Within this new framework, China should be invited to become a full member (and India and others as the case warrants). China will be reluctant to accept, as diplomatically Beijing still likes to posture as a developing country rather than as a major power. Since China is both a developing country and a power of consequence, its foreign policy should explicitly embrace both of these aspects of reality.

Second, the International Energy Agency has worked out the most comprehensive set of multilateral agreements to minimize the harm of either potential or actual oil supply disruptions. All major energy consumers are IEA members except China. The United States should take the lead in encouraging the IEA either to sufficiently change its requirements for membership to include China (an effort that is not likely to succeed) or to create a special category of "partnership" through which China can fully participate. Such an invitation would require Beijing to swallow some pride in accepting a special category of association and would also obligate Beijing to formally obey the disciplines of participation in the multilateral regime.

The above U.S. initiatives and Chinese responses, if positive, would signal to each that the other is prepared to engage in long-term cooperation on an issue of vital economic and security importance.

CONCLUSION

Despite powerful interests that should promote long-term constructive U.S.-China engagement for mutual benefit, there are in fact serious obstacles that make this desirable outcome very far from certain. Key is the set of vexing questions each country has about the other - questions that by nature have no definitive answer. The result is increasing distrust even as cooperative relations grow. It will require ongoing hard work and creative thinking to develop measures that address immediate interests while also signaling long-term cooperative intentions. Such measures are vital to deepen the reservoir of mutual trust to the point where each side feels confident enough to adopt measures that avoid a cycle of pernicious self-fulfilling prophecies.

DAY V

THE TOP TEN REASONS THE U.S.-CHINA RELATIONSHIP
CAN (AND WILL) FALTER

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Senior government officials can become a captive to their “inbox,” having their time and attention dominated by the pressing challenges of the day. However, the inbox does not always allot equal space for all important tasks. Strategic challenges that do not manifest themselves as a daily crisis can be subtly squeezed out of the agenda.

While the current administration understandably devotes enormous amounts of time to Iraq, Afghanistan, Iran, and the Middle East conflict, the defining strategic challenge of our age is unfolding in a different region. The emergence of China in the context of a rapidly changing Asia is arguably the most important strategic development on our agenda. This view is endorsed by authoritative sources. For example, a report by the U.S. National Intelligence Council 2020 project suggested that the emergence of China resembles the advent of a united Germany in the 19th century and a powerful United States in the early 20th century, with the potential to dramatically transform the geopolitical landscape.

**A pessimistic view on the future
of U.S.-China relations is,
perhaps, the realistic view.**

However, the U.S.-China bilateral relationship and U.S. relations with Asia more generally, may not be receiving the kind of senior-level attention that their strategic importance requires.

It is critical that senior leaders in the U.S. government find the time to provide thoughtful stewardship of the U.S.-China bilateral relationship. Although the United States may have more important bilateral relationships in the world (Japan and the United Kingdom come to mind), there is no other bilateral relationship that, if managed poorly, could carry as many regional and global costs. In other words, because the stakes are so high and the consequences of failure so global, the U.S.-China relationship is perhaps the most significant bilateral relationship in the world.

There is strong cause for concern that the relationship will falter and burden us with the aforementioned consequences. Considering the degree of uncertainty in the present U.S.-China relationship, the current trend seems to be moving toward greater strategic distrust. Perhaps most notably, the problems that will emerge over the near- to medium-term are likely to be exceptionally challenging. All country-to-country relationships experience problems, but as this paper seeks to convey, the future of the U.S.-China relationship will almost certainly be turbulent. Although the frequency and magnitude of the expected perturbations would be difficult to manage in any

environment, in an environment of uncertainty, cool relations may quickly devolve into prolonged strategic distrust and great power rivalry.

The title of this paper was chosen not to be glib, nor to treat an important topic in a less than serious manner. The title, rather, is reflective of the fact that the U.S.-China relationship will be challenged by a variety of bilateral problems. Any single one of which could cause a downward spiral in political relations. The most probable scenario is that the United States will face a combination of these problems, along with burgeoning great power competition for global influence. Time will tell, but this burden might prove to be unmanageable. A pessimistic view on the future of U.S.-China relations is, perhaps, the realistic view.

This paper will first offer a view of the context and environment of the U.S.-China bilateral relationship in the next five to ten years. It will then examine the major challenges that will arise over this same short period.

STRATEGIC UNCERTAINTY

Chinese foreign policy has changed dramatically over the course of the last decade. PRC leaders have shed the principles upon which Deng Xiaoping shaped China's foreign policy in the modern era, such as "bide our time, build our capabilities" and "never take the lead." Today, China pursues its interests through a more creative and proactive diplomacy. In addition, China has greater capabilities and a widening "tool box" available to pursue its foreign policy goals. The net effect is that China is choosing deeper engagement and involvement with the outside world, and is increasingly effective at promoting its interests, even in the cases where its interests clash with the United States and other established powers.

China does not publish a national security strategy report, nor does it have a national security council to articulate such a strategy. Further, often obscuring the intent behind its actions, China remains an opaque country to those attempting to look in from the outside. China is often in the business of obscuring the actual intent behind its actions.

It may be true that Chinese leaders are operating and making foreign policy decisions in the absence of clear strategic guidance. As the U.S. Department of Defense report on the Chinese military states, "China faces a strategic crossroad. It can choose a pathway of peaceful integration and benign competition. China can also choose, or find itself upon, a pathway along which China would emerge to exert dominant influence in an expanding sphere...the future of a rising China is not yet set immutably on one course or another." In other words, China's strategic direction may be "to be determined."

Although the essential questions related to Chinese intentions once China has acquired greater power and influence may be unanswerable, analysts are looking closely at China's behavior to glean a sense of its strategic direction. At this early juncture of China's "rise," based on a candid and sober-minded review of China's decision-making and actions, we could reasonably conclude that Chinese leaders are comfortable with a more confrontational approach to the United States (bounded by the fundamental necessities to sustain trade and avoid unnecessary conflict). China's relationship-building around the world enables continued irresponsible behavior on the part of other governments, complicating U.S. and international efforts to promote more favorable outcomes. China has acted aggressively to promote multilateral organizations in Asia in which the United States is not represented. Its military build-up appears increasingly oriented toward com-

plicating, although not defeating, potential U.S. military operations. This growing “data set” of Chinese actions, U.S. analysts increasingly suggest, is creating an environment of distrust (and to be fair, an analyst might very well suggest from the Chinese perspective the many ways the United States is driving the relationship in the direction of greater distrust).

Can the discussion about China’s emergence really be generalized as being about rising powers and the response of status quo powers? Perhaps. However, it is also interesting to note that one does not sense the same level of anxiety in the United States concerning the emergence or rise of India, which is strikingly similar to China’s case. The major difference between the cases of India and China, of course, are their political systems and related sets of values.

Values always play a role in how countries view one another. However, it has been posited that this role of values is strongest in the United States. The theory states that unlike many countries, the United States is not defined by race, ethnicity, religion, or ancient culture, but rather by ideals, principles, and values. Thus, the theory continues, the United States views other countries first and foremost through the prism of values.

As we go forward, the implications for the U.S.-China relationship could be quite profound. Although the United States can surely maintain constructive relations with a country with which it differs on fundamental values, a values gap may place a “ceiling” on the quality and closeness of the relationship.

The United States views China in a negative light when values are considered. We differ over human rights, religious freedoms, and political systems. Many foreign policy elites in both parties in the United States believe that how a country treats its citizens reflects its behavior in the international arena. Thus the values gap matters in the most consequential form as a “trust deficit.” In the case of China, the very same “data set” mentioned above suggests this nexus between values and foreign policy will have a sustained negative impact on the United States.

Strategic uncertainty – trending toward strategic distrust – and a sustained values gap, can perhaps best be thought of as the “overlay” for the management of U.S.-China bilateral relations. Steady drift toward a great power global rivalry, if not outright adversarial relations, should be noted as a very real potential future. Whether we can arrest current trend lines and steer relations onto a more benign course remains to be seen. The answer to this challenge will certainly rest in large part in how we manage the challenge ahead.

THE TOP TEN REASONS FOR A STRAINED U.S.-CHINA RELATIONSHIP

Significant challenges lie ahead for political leaders in Washington and Beijing. The following list of potential challenges is far from exhaustive. It mostly sets aside “domestic politics,” although one can clearly imagine the respective domestic political consequences. The list also seeks to identify *potential* and likely problems rather than those that are long-standing and sustained in nature. For example, it includes “military mishap” and “Tiananmen-like crack down” as opposed to “military build-up” and “human rights.” That said, it includes both immediate impact events, as well as problems that appear more gradually, simmer, and metastasize. This paper thus aims to illustrate the difficulty political leaders will face, not only given the environment of uncertainty and distrust, but in dealing with a set of challenges that are dynamic, evolving, and in many cases, unfamiliar.

Military Mishap

China's military will increasingly operate outside its sovereign territory and further from its own shores. Determined to have a truly "blue water" navy and greater power projection in general, the People's Liberation Army (PLA) is rapidly acquiring the necessary capabilities to meet these objectives. Military acquisitions are accelerating across the full spectrum of operations including air, ground, space, surface, and underwater.

A residual effect of these developments is increasing contact between the U.S. and Chinese militaries. Past failures of U.S. and Chinese military operators attempting safety in close proximity are quite well known such as the EP-3 collision. However, there have been many more "incidents" unknown to the public which were arguably even more dangerous. For example, in the mid-1990s, a PLA submarine was almost fired upon when it came too close to the U.S. aircraft carrier Kittyhawk. As the Chinese did not have hostile intent, this would have otherwise been a deadly miscalculation and the political fallout would surely have been swift and severe.

China's military will increasingly operate outside its sovereign territory.

Unfortunately, the U.S. and Chinese militaries have made very little progress in making the operating environment safer. Although the two sides signed a "military maritime consultative agreement" in 1998, implementation of the agreement lagged and then completely halted

after the EP-3 accident (a counter-intuitive response if ever there was one). The Chinese military continues to resist confidence-building measures that involve "transparency," and remains a very opaque and secretive institution. Specifically, the PLA is still reluctant to provide information on its orders of battle, weapon systems, budget, pay scales, and personnel force structure. It is also extremely reluctant to open its bases and facilities for viewing by foreign defense delegations. The PLA continues to refuse operator-to-operator interactions, discussion of maritime "rules of the road," and joint exercises even in benign areas such as disaster response. The combination of an ever increasing operational proximity, and lack of progress on even the most modest of measures to improve safety, makes for a dangerous mix indeed.

Sino-Japanese Tensions

Although China and Japan enjoy robust trade relations, their relationship is at or near its post-war nadir. On the surface, the issues that divide Beijing and Tokyo involve unresolved questions about their shared history. However, there is likely more that is animating policy in both capitals than just a dispute over shrine visits.

It is fashionable to discuss the so-called "rise of China" today. However, it is important to note that China's evolution is unfolding at a time of other profound changes in Asia. The region is witnessing the re-emergence of Japan. Regardless of the domestic Japanese debate over Article 9 of the Constitution, what is very clear is that Japan is already acting with increased confidence, assuming new roles and missions, and exploring the scope of what might constitute a renewed position of leadership in Asia.

Throughout their very long respective histories, the power relationship between China and Japan has almost always been clear. At times China was the dominant power, and on occasion, Japan has

been the stronger country. With no one country emerging as dominant, both countries rarely see each another as equal powers. In terms of economic might, military capability, and diplomatic influence, China and Japan appear poised to share a co-equal power status in the near term, as well as an unstable regional rivalry.

Given the U.S. military alliance with Japan, however, problems between China and Japan seamlessly merge with problems between China and the United States. At a minimum, the close relationship between Washington and Tokyo may simply be another source of unease and distrust in the eyes of China, and the consequences may ultimately be more severe.

China has been increasingly assertive in its incursions into Japanese Exclusive Economic Zones (EEZ) in the Ryuku Island chain, including initiation of a gas exploration project just outside the Japanese EEZ. Anti-Japanese rhetoric in China has been extremely aggressive, harnessing a nationalism that, while helpful to the regime in Beijing, is also difficult to manage. New attitudes are also evident in Japan. By and large, the Japanese are tired of apologizing, and they are more determined to protect their sovereignty.

The United States is obligated by treaty, friendship, and national interest to come to the defense of Japan. According to the treaty language, this commitment extends to “areas administered by Japan” which includes territory that is still in dispute between Tokyo and Beijing. Crisis and/or conflict involving the PLA and the Japanese Self-Defense Forces is growing more likely, and in such a case, the United States and China would find themselves also in conflict.

The Taiwan Strait

Taiwan is the quintessential example of a “long-standing” issue dividing the United States and China. However, the environment in the Taiwan Strait is rapidly changing, and is in many respects growing more dangerous. Although China asserts that it can successfully manage differences across the Strait by engaging the political opposition, there are other troubling developments that could lead to great tension between Washington and Beijing.

What remains constant is that Taiwan is *sui generis* for Chinese leaders – it is viewed as a regime survival issue. However, our traditional means for the management of differences with China over Taiwan are being stressed in a variety of ways.

The first trend relates to China’s military modernization efforts. Chinese investment in the military is extremely robust, and more specialized and sophisticated than in the past. The Taiwan mission has served as a focal point for the various elements of the defense community – those that do acquisition, training, logistics, doctrine, etc. – to focus on the single mission. This creates synergies that have allowed the PLA to improve quickly. China’s military is developing real capabilities, and real options if asked to operationalize the situation by civilian leaders.

The second trend is quite remarkable given the aforementioned developments. Coinciding with the PLA build-up, Taiwan’s defense expenditures have radically declined over the last decade. The legislature is very reluctant to support the necessary investment in capability for Taiwan’s self-defense. While the reasons are complicated and rooted in domestic political rivalries within Taiwan, the net effect is a military balance tilting increasingly in Beijing’s favor.

The third trend line relates directly to Taiwan’s domestic politics. Taiwan’s domestic debate is increasingly provocative to the mainland. While the United States can celebrate and endorse

Taiwan's political achievements, one cannot "wish away" the PRC's very negative view of these same developments. Through political liberalization, Taiwan unleashed forces over a decade ago that will not be rolled back, and the fact is that issues associated with Taiwanese identity and the desire for international space are very threatening to leaders in Beijing

Fourth, China's leadership is insecure and neuralgic about Taiwan. Although Hu Jintao may ultimately prove to be a "moderate/pragmatist" on Taiwan, in the short term he is probably more vul-

Taiwan increasingly looks like a U.S.-China problem rather than a problem for regional democracies.

nerable to provocations from Taiwan. Hu faces enormous pressure to respond in a resolute, firm manner to Taiwan's political maneuvering. Although Beijing's recent diplomacy with the Pan-Blue opposition shows a more creative side, the promulgation of an Anti-secession Law last spring showed their insecurities.

The fifth trend relates to Taiwan's increasing isolation within Asia. China has successfully cast Taiwan as the provocateur, and Asians increasingly shy away from interactions with the authorities on Taiwan. The net effect is that Taiwan increasingly looks like a U.S.-China problem rather than a problem for regional democracies.

These various trend lines are unfolding at a time when each of the three major participants in the cross-strait equation has less flexibility and ability to influence each other. 2008 may present "the perfect storm," with a Taiwanese presidential election sure to elicit independence rhetoric, China preparing to hold the Olympic Games and thus wary of disruption across the Strait, and the United States holding an election in November and distracted from cross-strait problems.

Economic Nationalism

In the case of Asia, globalization is not simply leading to interdependent but "hyper-interdependent" economies and relationships. In the case of China, it is equally dependent on the outside world at *both* ends of the economic chain: the front-end for raw materials, FDI, and know-how, as well as the back-end for the export market. However, China also finds itself with an unusually high amount of leverage on the United States and other large trading partners. The most obvious benefit to most modern economies from trade with China is access to cheap goods, but in our own case, China's position is even more complicated.

As China further increases its holdings of U.S. debt, we are further dependent on China to sustain its role in underwriting our debt and helping to keep our own interest rates low. China increasingly finds itself in a position where it needs the U.S. economy for its own interests. Former Deputy Secretary of State Richard Armitage recently described the situation as one where "we each have a gun pointed at one another's head." Others have suggested that this represents the economic version of mutually assured destruction.

The economic relationship between the United States and China argues for a shared, collective interest in political stability and a secure environment so that commerce can continue to enrich all concerned. However, the expanding trade relationship is revealing a new divisiveness. The United States and China have grown quite accustomed to handling long-standing trade issues such as the

bilateral trade deficit, currency valuation, and international property rights violations. What is less clear is how Washington and Beijing might deal with creeping economic nationalism, and the potential nexus of political and security issues impacting trade policy.

In a manner of speaking, CNOOC was a dry-run for Chinese investment into the United States, and the associated domestic debate in the United States. China is wealthier, has dollar holdings, and will naturally seek to invest money in the United States, to include the purchase of U.S. assets. This is a normal feature of a mature trading relationship between modern economies.

In the aftermath of the CNOOC controversy and the Dubai ports embarrassment, China may attempt to choose “politically correct” investments in the near term. However, the likelihood that more contentious cases will arise in the future is quite high. Although the WTO and other mechanisms exist to ensure fair trade, exemptions exist for security. How broadly or narrowly “security” is defined may have less to do with the assets in question, and much more to do with the political environment at a given time.

Confrontation in Regional and Multilateral Organizations

It was not long ago, that conventional wisdom held that it was in the interest of the United States for China to participate more actively in regional affairs, and in particular, multilateral organizations. It was felt that if Chinese leaders became less insular, less inward-looking, and more active in regional affairs, we would start to see more of the “right” kind of behavior from China. The jury may still be out on this case, but it is increasingly apparent that this theory is a slight miscalculation. As China plays a larger role in regional affairs and multilateral organizations, engaging in the region on its own terms, it brings an agenda that does not entirely match that of the United States.

China increasingly identifies multilateral and “regional” approaches as diplomacy that exploits its comparative advantages. In the past, participation in regional organizations was inconsistent with Chinese leaders’ perceptions of how best to promote national interests. Previous Chinese leaders felt their optimal chance for success lay in “bilateralizing” all concerns. In contrast, the PRC now uses multilateral and cooperative frameworks to further its interests on many fronts: to convince others that it is not a threat, marginalize Taiwan, balance against U.S. bilateral alliances in Asia, and maximize Chinese influence at relatively low cost.

China is currently an active participant in existing regional organizations and is a key driver in formulating respective agendas and outcomes. In many cases, China has shown an increased willingness to confront the United States in Asia within these various forums. In 2004, for example, China was the single biggest obstacle to the endorsement of the security agenda for the APEC meeting in Chile, an agenda to which all leaders, including China’s, agreed the previous year in Thailand.

China has sought to bolster its regional influence in organizations which exclude the United States. Although these have initially tended to focus on defining and securing China’s borders, they also reflect a gradually broadening strategic concept of regional influence and the deliberate marginalization of the United States. A prominent recent example is the Shanghai Cooperation Organization, where, despite the non representation of the United States, China pushed the members to begin a discussion on the future of U.S. forces in Central Asia.

To date, confrontation within multilateral organizations has not been terribly consequential. This is partly due to the fact that multilateral and regional organizations in Asia have been weak by design. However, it is quite possible that existing organizations will become more empowered and

new organizations created (e.g., the East Asia Summit). Over a relatively short period of time, China could exert influence in a manner that orients multilateral organizations in Asia in directions that complicate U.S. interests. In such a scenario, China's influence and the unwillingness (or inability) of others to respond within multilateral organizations leaves the United States facing weak multilateral organizations to which it belongs, and stronger, unfriendly organizations from which it is excluded. High profile confrontation is a strong possibility.

Severe Human Rights Violations

China today remains a country with an extremely poor record on human rights and religious freedom. Like Taiwan, the human rights issue is not a new item on the agenda of U.S.-China relations. Sustained human rights abuse on the part of China is something that is already factored into the careful management of bilateral relations in Washington. However, the possibility of a "Tiananmen-like" crackdown by Beijing may actually be increasing for a variety of reasons – something that

seemed unthinkable in the post-Tiananmen era until this point. The reasons are as follows:

In an environment of strategic uncertainty and distrust, a Tiananmen-like incident would be disastrous for U.S.-China relations.

First, the sheer number of domestic disturbances is on the rise. We must hedge a bit in saying so with great certainty because the data is so imprecise. However, even the figures released by Chinese authorities suggest that "public disturbances" are registering at enormous rates in China – over 74,000 individual incidents in 2004 alone.

Second, the role of technology in capturing the heavy-handed response of Chinese authorities presents a new challenge for Beijing's leaders. It is quite possible that images of a brutal Chinese crackdown on citizens could be captured digitally and beamed around the world in near-real time. The means for controlling how disturbances and the response are represented are diminishing.

Third the volatile mix of potential "domestic threats" looms large in the eyes of the Chinese. In addition to traditional activists, China has to occasionally contend with discontent among the middle class. As the old Bob Dylan song goes, "When you ain't got nothing, you got nothing to lose." Yet private land ownership, business ownership, and greater awareness of global standards regarding labor and health standards may encourage public opposition. Religion may play a role, given that attendance in house churches is reportedly exploding in China, and that the Falun Gong has not been completely eliminated. China's Muslim population in Xinjiang may become more radicalized, thus opening the possibility for more aggressive measures from Chinese authorities. Looking further into the future, the 71 year-old Dalai Lama will pass at some point, inevitably sparking a dispute between Beijing's hand-picked replacement and the Tibet community who will support the Dalai Lama's real successor. Despite the modern image of Tibetans as being peaceful, the Chinese are well aware of the history of violent resistance in Tibet.

Again, the Chinese may be more vulnerable to a repeat of a Tiananmen-like crackdown than they feel comfortable admitting. In an environment of strategic uncertainty and distrust, such an incident would be disastrous for U.S.-China relations.

Energy is a Divider, Not a Uniter

One of the key drivers of Chinese foreign policy is a requirement to establish secure, reliable access to energy resources that lie beyond China's borders. Sustaining China's economic growth is vital to the regime, and thus there is a growing perception among Chinese leaders that increasing reliance on foreign energy creates vulnerabilities and risks. In order to secure the energy required to support China's domestic growth, China has embarked on an effort to promote diversification of supply as well as acquire overseas assets. China's growing demand for energy will have an impact on the United States and others. It will cause higher prices for foreign crude, increasing environmental degradation, and competition over disputed maritime boundaries. On the other hand, China's increasing reliance on the outside world may present the United States with foreign policy opportunities like increased cooperation on maritime security, counter-proliferation, and combined efforts to promote stability in key oil producing regions.

The evident trend lines we are witnessing, however, suggest that we are heading in the wrong direction. In the simplest and most straight-forward terms, China's strategy is to attain diversification of its supply sources, and greater ownership of overseas assets that relate to energy production and export. However, there are other foreign policy implications. The logistics train also needs to be secure to ensure minimal risk of the delivery of energy to China. China is also aware that owning energy supplies does not mitigate the risk of disruption without having the military capability to protect overseas assets, which requires developing its own power projection capability.

The United States is highly attuned to the negative effects of these developments. These effects are notably broad, as China's pursuit of energy security complicates U.S. foreign and security policy interests worldwide. In this regard, three countries come to mind – Sudan, Iran, and Venezuela. China typically does not address human rights and non-proliferation in its foreign relations, but the net effect in these three countries is not simply benign neglect where irresponsible behavior is concerned. Rather, China is likely engaged in relationship-building that enables continued irresponsible behavior, and complicates the efforts of the United States and other countries to promote different outcomes. In Sudan, as we have worked with other countries to address the genocide in Darfur, China has continued to support the regime in Khartoum with lucrative oil deals and even arms sales. In Iran, as the EU-3 have attempted to address the nuclear challenge through diplomacy, China has continued to support Tehran with oil purchases and assurances that China won't support action in the United Nations against Iran. And While Venezuela's President Hugo Chavez has endeavored to spread anti-Americanism throughout the hemisphere, China has given him what he so desperately needs in order to sustain his efforts – reduced reliance on the U.S. market for Venezuela's oil exports.

Although the above complications are quite serious, they may not manifest into an energy "incident" or crisis. However, China's growing interest in exploring disputed off-shore areas could certainly impact U.S. interests in a direct way, and project us quickly into a crisis atmosphere. Many of China's existing disputes are with friends of the United States, but in some cases, with treaty allies. As discussed previously, tensions are very likely to continue mounting between China and Japan, with energy only accounting for a part of the story. While our generic response to maritime territorial issues is legalistic and non-committal, we could end up choosing a more robust U.S. response if our ally were faced with aggressive actions from China.

Infectious Disease and/or Environmental Disaster

Some analysts suggest that, learning from the SARS crisis of 2003-2004, China has approached the threat of avian flu with greater transparency and a greater willingness to cooperate with the international community. However, the residents of Harbin might be among those who dispute that the “right” lessons were learned from SARS. More than a year after SARS, when a chemical spill polluted the city’s main water source in 2005, the authorities engaged in a cover-up effort that ultimately proved futile. As more people were exposed to the toxin Benzene than necessary, the authorities pondered ways to control information about “sudden events” rather than mounting a legitimate crisis response.

It is quite easy to imagine China as the main source of a new infectious disease or environmental catastrophe. Regarding the former, China has virtually no rural health care system, and much of the population conducts day-to-day activities in third-world, unsanitary conditions. As for the latter, China is host to six of the ten most polluted cities in the world, and the government is still reluctant to seek tighter regulation and enforcement of environmental standards. It is harder to imagine, even in the post-SARS period, that China would respond to a crisis in the timely, forthright manner required to save lives.

The common factor between infectious disease and environmental catastrophe is the tendency of these problems to extend past sovereign borders once they are unleashed. With modern air travel and other infrastructure, disease is likely to spread beyond borders even before an epidemic outbreak is identified. In the case of the environment, a similar problem arises. For example, Harbin’s pollutants threatened approximately 70 Russian cities and villages, while China’s great rivers are the source of potable water for several countries in Southeast Asia. The United States is not immune, so to speak. Direct flights between the United States and China would surely bring infectious disease into our country, and the impact of China’s air pollution is already being felt in our West Coast cities.

China’s response is largely unimaginative. To be sure, the magnitude of these challenges is almost overwhelming. However, China’s preparations for future problems in the area of infectious disease and environmental catastrophe appear aimed mostly at “political damage control” rather than real-life damage control. Legislation under consideration in China today very specially identifies health and environment as areas where news organizations would be prohibited from reporting on so-called sudden events. After the SARS experience, the international community and the United States would be far less forgiving to future mishandling of these types of problems.

Failures at Regional and International Problem-Solving

Implicit in the “responsible stakeholder” approach to China is the notion that the U.S.-China relationship is in a probationary trial period. The essential proposition is that China’s emergence as a power with growing influence accords it the opportunity to play a prominent role in regional and global affairs. Further, China can demonstrate to other great powers and the global community that it will play that role responsibly, and act in a manner that supports peace, stability, and prosperity as defined by the current cast of powers or stakeholders.

It is not entirely clear what the United States will do if China repeatedly fails to live up to the “responsible stakeholder policy” during this trial period. In other words, where will we find ourselves if China proves beyond a doubt to be an “irresponsible stakeholder”? Although the data set

might be unclear at this juncture, it is increasingly evident that China may be on the path toward irresponsible stakeholder status.

China will be key to the United States in global problem-solving efforts in the foreseeable future. For some time to date, China has been a permanent member of UN Security Council, as well as a nuclear weapons state. More recently, China has become a significant donor of foreign aid on every continent and maintains a global diplomatic infrastructure. The elements of Chinese soft power, including culture, language, sports, entertainment, and the arts, are employed around the world. Almost by necessity, China will be an integral part of all U.S. regional strategies, and a player in any ad hoc problem-solving frameworks.

If one were to take a current sampling of U.S.-China bilateral work on regional and global challenges, one would be very hard-pressed to demonstrate victory or even modest success as a result of our efforts. What is worse, while there is rhetorical attention to the cooperation on a variety of challenges, an actual positive grade would not hold up to close scrutiny. The Chinese continue to blame the United States for stalled progress on the Korean nuclear question, continue to enrich the regime in Tehran against U.S. pressures, and still offer military support to the Sudanese government, as Khartoum backs the genocide in Darfur. The list is actually much longer.

Failed attempts at regional and global problem-solving may not present an incident or crisis point, although an event as dramatic as a North Korean nuclear weapons test could bring the grand question of “responsible or not” to the fore. Over the longer run, we can imagine these failures having a debilitating effect on bilateral ties.

The “Unknown Unknowns”

Finally, one might argue that citing the “unknown” as a 10 top concern for the management of future U.S.-China bilateral relations is an unimaginative finish. However, two important points justify its inclusion.

First, virtually all the major disruptions in U.S.-China relations since normalization have come from unanticipated incidents. Problems have tended to simmer and create more burdensome difficulties over time, but the significant downward spirals emerged unexpectedly. Examples of such events are the accidental bombing of the Chinese embassy in Belgrade, the collision between a Chinese fighter and U.S. reconnaissance planes, a Congressional vote authorizing a visa to Taiwan’s President Chen Shui-Bian (after a high-level assurance that no visa would be forthcoming), and a bloody crackdown which was televised around the world through the new medium of 24-hour news coverage.

Second, the United States and China still lack any proven or “battle-tested” mechanism for crisis management. Much like the previously mentioned failures to create institutions for enhancing the safety of military operations, attempts to create infrastructure for political crisis management have failed miserably. For example, the Presidential hotline went unanswered after the Belgrade bombing, and Secretary Powell’s attempts to reach Foreign Minister Tang through the Operations Center after the EP-3 collision were also met with non-response. Although we are led to believe that Chinese and American think tanks are intensely studying “crisis management” even to the extent of “wargame” scenarios, there is more reason to believe that the limited mechanisms in place will fail yet again when put to the test.

Although Secretary Rumsfeld brought the phrase “unknown unknowns” into popular lexicon, the concept has been well understood by China experts in the United States for decades. The likelihood of a major disruption in U.S.-China ties from an unknown source is very high in the near future.

CONCLUSION

The United States will pay a price for a prolonged strategic distrust with China. If China has already made a strategic decision that they must dislodge or dislocate U.S. influence, even if it means opting for a competitive or adversarial relationship over the longer term, then there is little that foreign policy elites can do to arrest current trends. On the other hand, if Chinese foreign policy is being conducted in an ad hoc manner, and the outcomes we are observing do not reflect hostile strategic intent, then the current U.S. administration and its successor will have numerous

opportunities to steer relations in a more positive direction. However, for an opportunity to become more consequential, pro-active efforts on the part of leaders are required.

The United States will pay a price for a prolonged strategic distrust with China.

The problems identified in this paper are not simply remote possibilities in our future, but constitute a range of very likely challenges for the U.S. government. Given an “overlay” of strategic dis-

trust, characterized by sustained differences among fundamental values, and trend lines verging in the direction of U.S.-China strategic rivalry, management of problems will be extraordinarily difficult. Given the magnitude of likely consequences of poor U.S.-China relations, it is worth the time and attention of senior political leaders in both countries to exercise firm control with respect to our frequent and growing bilateral interactions. Furthermore, it may prove to be the case that today’s pessimists will ultimately be seen as pragmatists in the near future.

U.S.-CHINA RELATIONS: THE U.S. DOMESTIC CONTEXT

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U.S. relations with China have for decades been subject to the push and pull of domestic political influences and pressures. As Ambassador Richard Holbrooke recently noted, “[w]hat vastly complicates U.S.-China relations is that every major policy issue between the two countries is also a domestic matter with its own lobbying groups and nongovernmental organizations ranging across the political spectrum.”² These influences have ebbed and flowed over time. During the 1950s, the “Who Lost China” debate and domestic fears over Communist infiltration played a major role in shaping U.S. attitudes toward “Red China.” By the 1970s, the strategic priority of containing the Soviet bloc had submerged hostile domestic attitudes toward China and allowed President Nixon to make his historic “opening” in 1972. Subsequently, the collapse of the Soviet Union eroded the foundation on which the Sino-American relationship had been built, leaving it exposed to the currents of domestic opinion and the hailstorm of criticism after the events at Tiananmen Square on June 4, 1989.

Seven Presidents from both political parties have pursued a strikingly consistent policy of engagement toward China.

Through it all, seven Presidents from both political parties have pursued a strikingly consistent policy of engagement toward China with the goal of integrating the People’s Republic into full and constructive membership in the international community.³ On the surface, the George W. Bush years have seen stability and relative calm in U.S.-China relations. Since the resolution of the EP-3 spy plane downing incident in April 2001, and especially after 9/11, China and the United States have had few disputes of note. This surface calm masks a wide range of policy differences, however, and is largely the result of American preoccupations elsewhere rather than of any fundamental strategic choices or the resolution of key differences. On the Chinese side, there has been an obvious, strategic determination, especially since 2001, to avoid open confrontation with and public criticism of the United States.

Starting last year, however, significant concerns began to surface in the United States about China, driven by China’s dramatic economic rise, its assertive and successful regional diplomacy, and its global search for energy resources. Domestic constituencies have reasserted themselves in debates over China, and the nation’s three-decades-old policy of engaging China is being questioned anew. As a result, the domestic political dynamic surrounding U.S.-China policy is becoming increasingly complex and challenging. Anxieties about China among policy makers have become fairly deep and broad-based. Indeed, Bob Zoellick, the former Deputy Secretary of State

and the Bush Administration's point person on China policy (and our Aspen colleague), noted bluntly in a major speech last fall that "many Americans worry that the Chinese dragon will prove to be a fire-breather. There is a cauldron of anxiety about China."⁴

This paper provides some notes and observations about the sources of that anxiety and the challenges it presents for policy makers in fashioning and executing a durable U.S.-China policy.

THE CAULDRON OF ANXIETY

Domestic concerns about China have long played a role in the shaping of U.S.-China relations. The current environment is, however, becoming increasingly volatile. The sources of today's concerns about U.S.-China policy come from a broad range of quarters – much broader than the out-

On the Chinese side, there has been an obvious, strategic determination, especially since 2001, to avoid open confrontation with and public criticism of the United States.

cry over Japan's economic rise in the 1980s or over China's human rights record in the 1990s. Republicans and Democrats, liberals and conservatives, business and labor, and the secular and the religious all have their own reasons for joining the chorus of concern about China. Further, the concerns being raised today are fundamental and aimed at the question of whether a rising China will inevitably be antithetical to U.S. interests. Additionally, for reasons explored below, there is no strong, self-aware, and cohesive constituency in the United States that advocates for closer ties with Beijing: a significant change from the 1990s when the business community broadly

saw China – again quoting Bob Zoellick – as the "land of opportunity." Indeed, we are entering a period that, from a domestic political perspective, will be exceedingly challenging.

Anxieties about China are especially pronounced in the U.S. Congress. A 2005 survey by the Zogby organization taken for the Committee of 100 showed a sharp contrast between views of Congress, the business community, and the general public toward China. The Zogby poll showed a majority of ordinary Americans (59 percent) holding a favorable view of China, in sharp contrast to 19 percent of Congressional staffers. Indeed, an overwhelming majority of 79 percent of congressional staffers surveyed held a negative view of China.⁵ While 36 percent of Congressional staffers saw China as a "serious military threat to the United States," only 15 percent of the general public shared this view; and similarly, 34 percent of congressional staffers thought U.S.-China relations were "getting worse" compared to just 12 percent of the public.⁶ Meanwhile, the bipartisan, Congressionally-appointed U.S.-China Economic and Security Review Commission stated in its report to Congress at the end of last year: "We believe that China and the United States are the chief protagonists on the world stage. [...] China's methodical and accelerating military modernization presents a growing threat to U.S. security interests in the Pacific."⁷

What underlies the increased anxiety over China? Four observations seem relevant: (1) the consuming preoccupation of policy makers with Iraq and the war on terror and the resulting failure to develop a framework for dealing with the challenges presented by China's rise; (2) the break-up of the historically strong and fairly uniform support of the business community for engagement

with China in the face of China's economic rise; (3) the coming together of left and right – including the religious right – in a values critique of China; and (4) an unresolved battle of ideas over whether China's rise will inevitably conflict with U.S. interests.

Bandwidth Limitations and Preoccupations

Surprise creates anxiety. Policy making systems and policy makers have only so much “bandwidth” at any one time. China's dramatic, multifaceted rise in economic, military, and “soft” power over the past half decade took place at precisely the same time as administration policy makers were preoccupied with and overwhelmed by the demands of the global war on terror and the war in Iraq. The result was a senior policy team – and a broader political community – caught fairly unawares by the speed, scope, and size of China's economic rise (manifest in China's enormous and growing trade surplus with the United States and its massive currency reserves); the dramatic change in its approach to regional multilateral organizations (especially in the Pacific region, and often at the direct expense of the United States); a much more active and assertive Chinese foreign policy in general; China's surprisingly successful pursuit of soft power; and its aggressive global search for resources necessary to support its economic growth and stability (resulting in Chinese economic partnerships with regimes the United States considers problematic and seeks to isolate).

**There is no strong constituency
in the United States that
advocates for closer ties
with Beijing.**

China's long-anticipated rise has become a fact, creating many more places around the globe where U. S. and Chinese interests can intersect and conflict than even just five years ago. Quite simply, the United States has not developed a framework for addressing this current and rapidly moving set of circumstances. U. S. engagement on China-related issues in the past five years has tended to be reactive or one-dimensional. Indeed, it has not been uncommon to hear comments about the lack of a U.S. presence in East Asia, and the U.S. tendency to focus exclusively on issues of concern to itself when it does engage.

Tom Christensen of Princeton University noted last summer in an unpublished paper for a CSIS study group that many policy makers:

seem particularly worried about the period following September 11, 2001, as the United States seems to have become distracted by the Global War on Terror while China has quickly and dramatically gained leverage in Southeast Asia, Northeast Asia, and even Australia with impressive economic and diplomatic initiatives. For example, until very recently, a widespread impression in the region has been that when the United States does engage with states in Southeast Asia it often sounds monotone and obsessed with terrorism at the expense of other issues. In the meantime, China has kept its eyes on the great power prize and has created strategic dependencies on China among its neighbors and has prevented balancing coalitions from forming by embracing regional multilateralism in an almost sickly sweet fashion.⁸

Kurt Campbell recently wrote:

The demands, mostly unanticipated, of the martial campaigns in the Middle East have had the additional consequence of diverting the United States away from the rapidly changing strategic landscape of Asia precisely when China is making enormous strides in military modernization, commercial conquests, diplomatic inroads, and application of soft power. Rarely in history has a rising power made such gains in the international system largely as a consequence of actions and inattentiveness of the dominant power. Indeed, Washington has been mostly unaware of China's gains in the past few years, many of which have come at the expense of the United States.⁹

With policy makers distracted, no overall framework has been in place for understanding and addressing the current challenges in U.S.-China relations. Surprise, lack of time, and lack of intellectual capital all tend to produce anxiety.

The Business Community: Monolithic No More

Since China's economic reforms were launched in 1978, and especially since Deng Xiaoping dramatically opened China to the global economy in the 1990s, U.S. businesses have seen China as a land of opportunity and have been the key constituency advocating a policy of engagement and integration with China. U.S.-China economic ties have grown dramatically over the past several

Remarkably, 59 percent of Americans hold a favorable view of China, in contrast to 19 percent of Congressional staffers.

years, with total bilateral trade rising from \$5 billion in 1980 to \$285 billion in 2005. Nonetheless, business views on China today are decidedly more mixed. To be sure, China's growing market, increasing domestic demand for imports, and massive unmet infrastructure, technology, and transportation needs, make it an attractive market for large U.S.

multinational manufacturing and financial services firms. China's remarkable economic growth and resulting presence in global capital and commodities markets, however, has had significant impacts on economies and businesses around the world, including in the United States. Increasing numbers of smaller and medium sized U.S. firms now worry about the impact of China's economic rise on their fortunes. Simply put, in an era of globalization, China's economic emergence is having a tremendous impact on U.S. markets, prices, incomes, and jobs.

There is now a clear difference in outlook between those large firms who are invested in China, and those smaller firms who increasingly confront China as a global competitor. These concerns are growing as Chinese firms have moved up the "value chain" to provide complex manufacturing facilities and skilled labor at a fraction of the U.S. cost, thereby challenging a broader range of firms. This move has hit key sectors of the U.S. economy hard – sectors which provide well-paying jobs with benefits, and that have never faced serious low-cost competition before. In the words of Harvard economist Richard B. Freeman, "what is stunning about China is that for the first time we have a huge, poor country that can compete both with very low wages and in high tech. Combine the two, and America has a problem."¹⁰ Politically, these dynamics have U.S. business interests looking to policy makers for protection – and these pressures are building in Congress.

There are four particular areas ripe for controversy in the economic and business arena. First is the sheer size of the U.S. trade deficit with China, which reached nearly \$202 billion in 2005 – accounting for 26 percent (the largest portion) of the total U.S. trade deficit of \$726 billion.¹¹ This deficit is in significant part structural – with China becoming the low-cost assembling and shipping platform for East Asia – and is therefore unlikely to change anytime soon.¹² The growth and scale of the trade imbalance with China has, unsurprisingly, fueled charges of unfair trade practices by China, which is accused of pursuing a mercantilist trade strategy by systematically protecting its markets and at the same time aggressively supporting exports by its national firms. These charges are open to dispute, not least of all by the fact of the substantial increase in U.S. exports to China. However, in light of the increase in higher-value Chinese imports, the scale of the deficit will remain a point of contention.

A second likely point of controversy that is less open to dispute is China's undervaluation of its currency (currently estimated at up to 40 percent) and its reluctance to take timely and meaningful steps to subject the yuan to market forces. The administration has tried to address this issue through low-key engagement and has not formally taken action against China for currency manipulation – rejecting in 2004 two applications to bring WTO cases against China's exchange rate policy. There are, however, political forces on all sides – Republican and Democratic policy makers, business people, and labor representatives – who see China's refusal to allow its currency to adjust as an unfair trade practice. They argue that China's undervaluing of its currency makes Chinese exports to the U.S. cheaper, U.S. exports to China more expensive, increases the U.S. trade deficit with China, and costs U.S. workers jobs. Both the U.S. Chamber of Commerce¹³ and the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)¹⁴ have accused China of manipulating its currency, thereby providing its exporters with a de facto subsidy that worsens our trade deficit with China. Democratic Senator Charles Schumer from New York and Republican Senator Lindsay Graham from South Carolina have responded by threatening to impose a 27.5 percent retaliatory tariff unless China moves to revalue the yuan.¹⁵ Others, such as Democratic Senator Evan Bayh from Indiana¹⁶ and Republican Representative Ron Paul from Texas,¹⁷ have expressed concern over the leverage China may gain from financing America's record \$800 billion current account deficit through its large purchases of U.S. dollar-denominated debt instruments, such as treasury bonds and Fannie Mae and Freddie Mac debt issuances.¹⁸

The third area of potential confrontation is China's failure to protect the intellectual property rights of U.S. companies. This failure has cost those companies billions of dollars in a wide range of industries from pharmaceuticals to entertainment. Groups such as the Business Software Alliance¹⁹ and the Motion Picture Association of America²⁰ have accused China of not living up to its WTO commitments to protect intellectual property from piracy. The U.S. Chamber of Commerce, for its part, has launched an ad campaign featuring a member of the United Auto Workers (UAW), purporting to show that counterfeiting by businesses in countries like China results in the loss of union jobs.²¹

The fourth major potential friction point in the U.S.-China economic relationship is competition for energy resources, which has become a driving force behind China's global foreign policy.²² China's "go out" strategy is aimed at securing – some say "locking up" – supplies of energy needed to support its economic growth and its ultimate stability as a regime. Energy diplomacy has been the focus of repeated senior Chinese leadership trips to the Middle East, Africa, and Latin America. This strategy and its scale directly impact U.S. interests in global energy markets. Equally significantly, U.S. security interests are affected by China's outreach to problematic regimes – including

Iran, Sudan, Burma, Venezuela, Uzbekistan, and Syria – where China’s deal-making can undermine the efforts of the United States and others to deal with these regimes on matters of human rights, nuclear nonproliferation, and democracy promotion.

These and other concerns were on full display last summer when the China National Offshore Oil Corporation made a bid for UNOCAL, a Los Angeles-based oil and gas company, for \$18.5 billion. This is a new dynamic, for until 2005 there was very little Chinese direct investment in the United States. Nonetheless, over a six week period, a firestorm of opposition to the transaction built to the point where CNOOC withdrew its bid due to what its CEO called “the political environment in the U.S.”²³ The magnitude of the opposition was such that within a week of the announcement of the bid, the U.S. House of Representatives had voted 398-15 to approve a resolution stating that CNOOC in control of UNOCAL “might take actions that would threaten to impair the national security of the United States.”²⁴

The arguments in opposition were many: (1) In a period of high oil prices and tight supply, CNOOC as a state owned company could hoard oil and gas supplies for China’s exclusive use – thereby reducing the reliable supplies available to the United States (Our colleague Jim Woolsey testified that the proposed deal was a “takeover attempt of a U.S. company by the most powerful communist dictatorship in the world...Oil can be used as a weapon of war.”);²⁵ (2) CNOOC’s purchase of UNOCAL would risk the transfer of sensitive dual-use technologies to China; (3) CNOOC’s bid was unfairly subsidized by the Chinese government (CNOOC’s bid was \$1 billion higher than Chevron’s initial bid for UNOCAL);²⁶ and (4) the Chinese government would not allow a U.S. company to make such an acquisition of a Chinese company.²⁷ Although these arguments have their pros and cons, they were not engaged in a substantive fashion during the summer of 2005. Rather, circumstances surrounding the CNOOC bid combined to create a “perfect storm” of opposition in Congress, including a tight energy market, high energy prices, and a competing earlier bid by a U.S. company. In the end, the CNOOC episode ended up being about the strong visceral concern among policy makers about China and its possible threat to U.S. interests.

The bottom line is that China’s economic rise has fractured the business community, which now has a much more mixed view of engagement with China. Protectionist pressures are also likely to build. China continues to grow at a strong pace (11.3 percent in the second quarter of this year) without the Beijing leadership showing an inclination to take significant steps to revalue its currency or to reduce its trade surplus with the world.²⁸ There are currently more than a dozen bills pending in the U.S. Congress seeking action to pressure Chinese action on its currency – and this is in a nearly full employment, low inflation U.S. economy.²⁹

Thunder from the Left, Lightning from the Right

At a time when there is little apparent bipartisan agreement in Washington, there is one issue on which the American political left and right are increasingly in agreement: China. Former National Security Adviser Sandy Berger remarked at a conference at the Brookings Institution last fall that China may be the only issue on which Nancy Pelosi and Tom DeLay could find agreement.³⁰ The left has been historically critical of China over its human rights practices and the right has been historically critical over both Taiwan and China’s population control policies. One can now add a list of issues of great concern to the religious right – religious persecution, human trafficking, and censorship. There is a new and increasingly influential force on the Republican right in foreign affairs and it finds itself in agreement with the left on values-driven foreign policy issues. China is a special focus of concern.

Like many aspects of China policy in the United States, the fusion of left and right has its roots in the aftermath of the Tiananmen Square crackdown. Tiananmen is the key inflection point in the politics of U.S.-China relations since Nixon's opening. Prior to June 4, 1989, nearly 75 percent of the American people had a favorable impression of China. By August 1989, that number had plunged to the 30 percent range, and it has never since approached pre-Tiananmen levels.³¹ Also out of Tiananmen emerged a robust critique of China's human rights policy from the left, inspired by a very effective group of Chinese student dissidents. Democrats (led by Nancy Pelosi and George Mitchell) found themselves joined with the wing of the Republican Party that had historically "despised and distrusted China's government for its continued allegiance to communist ideals, repression of religion, and draconian birth control policies."³² This fusion of forces fundamentally changed the approach to U.S.-China relations, forcing a sharp divergence from Nixon or Kissinger *realpolitik* and underscoring the evaporation of the Cold War rationale for the relationship.

Like many aspects of China policy in the United States, the fusion of left and right has its roots in the aftermath of the Tiananmen Square crackdown.

The influence of this cross-spectrum coalition in the domestic debate on China policy has grown stronger of late for two key reasons. The first is the growing interest of evangelical Christians in a broader range of foreign policy issues and its willingness to use its influence with a Republican administration. Second, the religious right and a number of groups on the left are having increasing success in finding common ground on foreign policy issues. This is new – and powerful. As one observer has written, "[t]he growing Christian solidarity movement presents a challenge no Republican administration in memory has had to face: a human rights force on the right openly critical of the morality of the administration's foreign policy."³³ The ongoing conflicts in Sudan are a leading example of the religious right, working in concert with groups on the left, succeeding in placing an issue on the administration's foreign policy agenda.³⁴

China's cultivation of closer ties with problematic regimes as part of its global efforts to secure energy resources has been subject to increasing criticism from both the left and right. In just the past year, for example, Republican congressman Chris Smith of New Jersey has condemned China at House International Relations Committee Hearings for a litany of offenses: (1) propping up Robert Mugabe's repressive regime in Zimbabwe; (2) supplying the Sudanese army with ammunition, tanks, and aircraft used in Darfur;³⁵ (3) draconian enforcement of its one-child policy that includes forced abortion and sterilization;³⁶ and (4) persecution of Christians, Buddhists, Muslim Uighurs, and Falun Gong practitioners.³⁷ Both Human Rights Watch³⁸ and the non-partisan U.S. Commission on International Religious Freedom (USCIRF) have joined in this latter criticism.³⁹ So has Senator Sam Brownback of Kansas, a likely GOP Presidential candidate in 2008, who has been active in condemning China's restrictions on religious freedom,⁴⁰ its failure to combat human trafficking,⁴¹ and its policy of harvesting organs from condemned prisoners.⁴²

China's efforts at internet censorship have also given critics a particularly strong issue with which to criticize the logic that engagement and human rights promotion are complementary. The Chinese authorities' success in securing the cooperation of U.S. technology companies to censor internet content available to Chinese users of leading search engines, and to aid in investigations of dissidents and other regime opponents,⁴³ have received substantial media attention. Such partner-

ships have been criticized by advocacy groups such as Amnesty International, which issued a major report on Google, Yahoo, and Microsoft just this past month,⁴⁴ as well as a significant number of members of the House of Representatives.⁴⁵ China's internet censorship efforts have also attracted the attention of the American religious right, who are concerned about how the authorities could act against Chinese Christians who use the web to organize underground "house church" meetings and download religious materials.⁴⁶

At the end of day, the key will be Presidential engagement and leadership.

Taiwan, of course, remains a constant issue of concern for members of Congress on the left and right. It is perhaps the issue on which cross-spectrum unity has been most robust and long-lasting, which is not surprising given its status as "the most sensitive and complex

issue [...] in bilateral Sino-U.S. relations."⁴⁷ There are bipartisan Taiwan Caucuses in both the Senate and the House that continue to press for more favorable treatment of Taiwan in U.S. policy, and just this past year, the House passed a resolution condemning China's anti-secession law by a vote of 424 to 4. After retreating from aggressive statements in its early days, the administration has managed to steer a fairly calm course to date with respect to Taiwan, but challenges will present themselves in light of political developments on the island.

The Battle of Ideas

A fourth point of uncertainty is the fundamental and unresolved disagreement in the Bush administration and the broader policy community over whether the rise of China is a positive sum opportunity that the United States should engage, or a zero-sum challenge that the United States must contain. As China's global influence has increased, so too has the intensity of this debate.

The school of thought that believes that engagement is not an adequate policy, or is even anti-thetical to U.S. interests, has significant influence within the administration and the Republican Party as a whole. Prominent neoconservative thinker Robert Kagan believes that a zero-sum U.S.-China competition for strategic preeminence is underway. Kagan warns that "the history of rising powers [...] and their attempted 'management' by established power provides little reason for confidence or comfort" because "rarely have rising powers risen without sparking a major war."⁴⁸ Along the same lines, international relations theorist John Mearsheimer asserts that "the United States has a deep-seated interest in making sure that China does not become a wealthy country because it will translate its economic might into military might and seek to dominate Asia. [...] Better to head that problem off at the pass by doing everything possible to slow down China's modernization."⁴⁹ Similar sentiments evidencing a deep anxiety about China's rise and the inevitability of conflict between the United States and China have also been expressed by the current administration in several key documents, including: the 2002 National Security Strategy of the United States;⁵⁰ the 2006 Quadrennial Defense Review Report ("China has the greatest potential to compete militarily with the United States and field disruptive military technologies that could over time offset traditional U.S. military advantages");⁵¹ the Pentagon's 2006 Report to Congress on China's Military Power (the People's Liberation Army "is engaged in a sustained effort to interdict, at long ranges, aircraft carrier and expeditionary strike groups that might deploy to the western Pacific");⁵² and statements by Secretary Rumsfeld and others.

Furthermore, in her now famous January 2000 *Foreign Affairs* piece, Secretary Rice asserted that China was “not a status quo power but one that would like to alter Asia’s balance of power in its own favor.”⁵³ Accordingly, Secretary Rice argued that China should be viewed as a “strategic competitor” and expressly advocated “containing Chinese power and security ambitions.” Although post-9/11, the Bush Administration abandoned such rhetoric and adopted a more traditional engagement approach to U.S.-China relations, the fact remains that these views have had – and continue to have – currency within the administration.

Indeed, the influence of this school of thought is illustrated by the speech of then-Deputy Secretary of State Robert Zoellick in September 2005, in which he called on China to become a “responsible stakeholder” in the international system. Zoellick’s speech demonstrates a clear need and determination to address directly the proponents of containment within his own party and administration. In the course of that speech, Zoellick explicitly rejected any comparison between China and the Soviet Union of the Cold War or the Germany of 19th century Europe, and stated directly: “For 50 years, our policy was to fence in the Soviet Union...for 30 years our policy has been to draw out the People’s Republic of China. As a result, the China of today is not the Soviet Union of the late 1940s. [...] We are too interconnected to try and hold China at arm’s length.” Kurt Campbell’s assessment of the speech thus seems entirely correct: “The majority of the speech [...] was intended for the domestic U.S. audience, particularly those most inclined to view China as the next great threat to U.S. power and prestige on the global stage. [...] Zoellick’s speech constitutes the pro-engagement camp’s first major counter-attack in the ongoing bureaucratic in-fighting over the future of U.S. policy toward China.”⁵⁴

CONCLUDING OBSERVATIONS

Domestic politics have long played an influential role in shaping U.S.-China relations. Yet despite the vicissitudes of politics and partisanship, American Presidents since Nixon have nonetheless continued to adhere to an engagement policy toward China. This consistent policy approach is about to become a lot harder to maintain. The domestic political landscape as it relates to China has changed in the past few years, and those changes, coupled with China’s dramatic rise in global affairs, will present a formidable challenge to maintaining a durable policy. At present, however, we are simply not prepared to deal with this massive change in global circumstances. The rise of China and the overall shift in the distribution of power to Asia is perhaps the most important long-term strategic challenge facing the United States, but we are only in the outset of developing a framework capable of dealing with it. Put another way, we have yet to “get our collective minds” around the problem. At the end of day, the key will be Presidential engagement and leadership. In a volatile political environment and with a problem of this moment, there is no substitute for the President.

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Concluding Observations

ASPEN STRATEGY GROUP WORKSHOP “CHINA’S MARCH ON THE 21ST CENTURY”

CONCLUDING OBSERVATIONS

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The Aspen Strategy Group summer session “China’s March on the 21st Century” was held in Aspen, Colorado between August 4 and 9, 2006, and the rich discussions touched on the dramatic importance of developments transpiring in the East while the lion’s share of America’s attention remains focused on Iraq and the Middle East. The ASG brings together the senior-most foreign policy and national security professionals from both sides of the political aisle to consider a pressing issue confronting the United States over a sustained period, with the assistance of commissioned papers and outside experts. In 2006, for the first time, an important group of Chinese interlocutors were also invited to participate for the first three days of our sessions and their contributions were most welcomed and illuminating. The introduction of knowledgeable international participants was seen as a valuable innovation to a gathering that has been almost exclusively American in its composition in the past.

After focusing for several years on matters relating to 9/11 and the larger war against terrorism, the ASG turned its collective attention East in 2006 to consider the strategic implications of China’s rise. In many respects, this gathering represents the elite of the foreign policy establishment, and their perspectives provide a kind of collective sense of what to expect when it comes to China policy in the months and years ahead. The conversations spanned five full days and there was a remarkable range to the dialogue, but several key observations emerged clearly during our proceedings. Please find below ten key elements from our meetings that stood out and help to underscore the richness of the deliberations in Aspen.

1. ***The costs of American preoccupations:*** One of the areas of surprising consensus, even among senior administration officials in attendance, was that the United States has been primarily preoccupied away from Asia and China in these last several years during a period of tumult and change in the Middle East. Indeed, there was a general sense that American policy towards Asia had suffered somewhat given the overriding concerns in Iraq, Iran, and Afghanistan. No one doubted that American attentions would return to Asia once this period of unpleasantness and military conflict in the Middle East subsides, but there was considerable anxiety that Asia was changing rapidly – particularly because of China’s powerful emergence – and that the Asia the United States would confront in several years time would be considerably different (and perhaps less amenable to U.S. interests and perspectives) from

the region as it is currently configured. In the meantime, there were concerns about how various U.S. friends and allies would fare in an Asian environment that will continue to put heavy pressure on regional actors to get along with Beijing.

2. **Primary Chinese preoccupations – the challenges at home:** Although there was considerable comment and appreciation for the inroads China has made in global diplomacy in recent years with their brand of “soft power”, there was a near universal acknowledgement that, for the foreseeable future, the Chinese leadership under President Hu would be profoundly focused on the domestic challenges of maintaining high economic growth while at the same time ensuring domestic stability. With incidents of labor unrest rising throughout the country, and huge gaps in income inequality on the rise, the challenges of co-opting, suppressing, and addressing issues of inequality of and the dispossessed, were seen as the most critical tasks confronting the new Chinese leadership. In this context of riding the tiger of Chinese economic expansion, there was considerable discussion of what kind of leader, really, is Hu Jintao. One participant summed him up aptly: “unlike previous Chinese leaders who had flair and a vision, Hu is primarily a fireman, rushing this way and that trying to take care of many small fires at once and seeking to ensure that they do not turn into large ones. He has no grand plan or intricate strategy beyond simply surviving”. The implications of all this are that while China has seen its external stature rise considerably in recent years, in the short and medium term, China will all be about keeping all the plates spinning at home. China needs a stable and relatively placid international environment in order to focus like a laser on what it really important to them in the current context: domestic growth and stability.
3. **The nature of the Chinese economy:** We spent two full days discussing the Chinese economy and the strengths and weaknesses of the new Asian engine of growth in Asia. There was considerable discussion around the dramatically increasing Chinese energy needs and how Asia has reconstructed its supplier and export networks to put China at the center of this vast chain of interconnected commercial interactions. While there was considerable discussion around the structural weaknesses of China’s domestic economy – enormous and increasing gaps between rich and poor, no social safety net for workers, an anemic banking system, vast environmental degradation, and rising labor unrest – there was no sign that investors were beginning to hedge on the enormous China bet being placed by global financial markets and industrialists. If anything, there appeared to be a noticeable gap between the clearly articulated anxieties around the Chinese domestic scene and the still headlong nature of most international investments and other commercial engagements into China. As one economist at the session put it, “companies are still rushing to China but the underlying weaknesses of the financial foundations of the Chinese economy means that we may be creating the mother of all bubble economies, and it will keep getting bigger until one day it will pop, with enormous consequences for the global economy.”
4. **A military coup? In China?:** One of the most astute observers of the Chinese domestic scene surprised the entire session with a warning about the prospects for a military coup in China in a potential future scenario of profound domestic political unrest. He reasoned that if President Jiang Zemin was concerned about such a possibility – he apparently commissioned several studies when he was in power about how military coups came about in developing nations in Latin American and Africa during the 1960s through the 1980s – then we should be more attentive to this possibility in the future. There was little follow on discussion of this important contribution during the session itself, but there was considerable subsequent com-

mentary during the dinners and private meeting times thereafter. This is clearly an issue that deserves more serious and sober reflection.

5. ***American domestic politics and the making of China policy:*** There was much commentary on how the center was disappearing on the U.S. domestic political scene in the formulation and execution of U.S. policy towards China. With the splintering of the business lobby – big multinationals still in favor of close ties with China while smaller firms increasingly feeling the pressure from the Chinese behemoth – there was no longer a strong and cohesive voice inside the country arguing unambiguously in favor of close, sustained ties with China. What’s more, rising anxieties on the right primarily over China’s military moves and strategic ambitions coupled with concerns on the left over labor rights and job losses have increasingly confronted policy makers seeking to construct a coherent centrist approach for dealing with China. In this sense, the biggest divisions over China policy are increasingly inside the two parties rather than between them. Among the group, there was every expectation that China policy in all its many manifestations would be much more contentious in the upcoming 2008 Presidential election creating temptations for demagoguery and distortion on issues ranging from religious freedom, military power, suppression of democracy, labor rights, to environmental degradation.

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6. ***New tensions in the neighborhood – Japan more than Taiwan:*** Interestingly, among the Asian specialists in the audience there was much more concern about ramping tensions between China and Japan than worries about flaring anxieties between China and Taiwan. There was real concern that due to a miscalculation or rising nationalism in both societies, a military clash was possible between patrolling forces around the disputed island territories or over some other nationalistic hot spot. Among the ASG group there was an underlying disagreement as to whether Japan’s new assertiveness was actually a positive development in a new and complex Asia. One group believed the Japan’s new muscularity was in fact a useful check on a rapidly emerging China; the other part of the group worried that there was something unpredictable and even unstable about Japan’s Yasakuni obsessions and historical revisions. There was, however, an overall consensus that managing Sino-Japanese tensions will be a more important task for American foreign policy in Asia in the coming months and years. The question of Japan’s role is as quietly contentious among some American Asianists as the matter of China’s rise.
7. ***Of Chinese soft power:*** There was considerable discussion about how many inroads China has made in Asia with its current focus on “peaceful rise” and careful and sustained diplomacy throughout the region. Some participants believed that China has made tremendous inroads in reassuring Asian friends of its intentions and objectives; others believed that Asian confidence was primarily a consequence of the enduring U.S. presence in the region. This disagreement over whether Asians have come to a certain confidence level in terms of China’s dominant role – with or without the existence of a robust American hedge – was perhaps the most interesting area of high level divergence of views during our Aspen sessions.

8. **The four schools of Asia policy makers in the United States:** One participant offered that among Americans who follow Asia, there were roughly four “schools” of thought for how to formulate and execute policy towards the region. These schools were described as the following.

- *The “China first” school:* This group places China at the center of American activity and strategy in the region. All other bilateral relationships are secondary to the prime directive of building a strong and resilient relationship with Beijing. This school was described as declining in influence.
- *The “bilateral alliances” school:* This group believes that the best way to deal with complex problems like China’s rise or North Korean nuclear provocations is through tight management of America’s security partnerships such as Japan, South Korea, Australia, and Singapore.
- *The “China threat” school:* This group, made up of hawks in the Republican Party, see China not as an enormous commercial potential but rather as a near future peer competitor of the United States. These hawks anticipate a future military clash with China just over the horizon.
- *The “transnational challenges” school:* This group, made up primarily of Democrats, believes that traditional arrangements and diplomacy based simply on power must be reassessed so that the major powers in the region can begin to more effectively deal with multilateral challenges such as global climate change, encroaching environmental degradation, the prospects of serious infectious diseases, and reliable and renewable sources of energy.

9. **Taiwan and its prospects:** There was much less concern than in recent years about the chances for a major military miscalculation or crisis across the Taiwan Straits. This was attributed to several factors, including the general success of Beijing’s strategy towards Taiwan and the political disorganization inside Taiwan’s fractious democracy. While participants were generally sanguine about the immediate future, there was some anxiety expressed about how a confluence of events – a Chinese desire for placidity in the immediate period before the 2008 Olympics, a still distracted America, and an increasingly frustrated DPP elite – might conceivably combine to create an unanticipated crisis that could upset peace and stability throughout the Asia Pacific region in the 2007-2008 time period. Several participants did speak up to praise Taiwan’s democracy and to declare in no uncertain terms that maintaining democracy in Taiwan to be a core foreign policy and national security concern of the United States in the years ahead. However, there was a clear sense of an overall distance in the relationship between Washington and Taipei. There was also some discussion about how to engage in a bilateral “project” between Taiwan and the United States, perhaps around a free trade agreement that might help mend a relationship that has drifted badly apart in recent years.

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10. ***Uncertainty about the future:*** In the concluding session of our five day retreat, there was considerable discussion around two potential paths for U.S.-China relations ahead. One, in which relations would remain relatively stable for years to come given the history of essential continuity in the policy of engagement and coexistence between the two states over the course of nearly thirty years and six Presidents, and a second, in which a host of frictions in the areas of trade, military, human rights, perhaps catalyzed by an unanticipated crisis, could lead to profound and continuing high tensions in the Pacific. There was much discussion around these potential future scenarios and no apparent consensus around what to expect next. However, all agreed that the stakes now are much higher than at anytime in the past and that the international community and the surrounding Asia Pacific region is watching carefully to see how the drama between the two great states of the Pacific will play out over the course of this first part of the 21st century.



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