

China's Global Activism: Strategy, Drivers, and Tools

by Phillip C. Saunders

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—*Phillip C. Saunders*

Executive Summary

Chinese leaders are pursuing a long-term grand strategy based on maintaining a peaceful international environment that allows China to build the economic and technological foundations necessary to become a rich and powerful country. This strategy supports the Chinese leadership's domestic objective of maintaining Communist Party rule by building an advanced economy and raising living standards.

Chinese leaders are focused on domestic challenges and view continued rapid economic growth as essential to maintaining social stability. Despite fears of hostile actions by the United States and Japan, they have repeatedly compromised on strategic issues as necessary to maintain economic growth. In practice, Chinese foreign policy reflects efforts to balance strategic and economic considerations and to coordinate the activities of diverse Chinese economic and political actors to advance national goals. Efforts to formulate coherent policy are impeded by bureaucratic and political conflicts of interest, while policy implementation is often hindered by incentives of Chinese actors to evade government directives that conflict with their interests.

China's increased global activism is intended to secure inputs for the economy; protect against a possible U.S. containment strategy; expand its political influence; and pursue its commercial interests. The timing and pattern of China's increased activism in different regions has evolved along independent strategic and economic tracks.

The strategic track is driven by international threats and opportunities and by China's changing role in the global balance of power (with leadership fears of possible U.S. actions to contain or subvert China a major factor). The end of the Cold War led China to establish relations with former Soviet states and anti-communist countries such as South Korea, Indonesia, and South Africa. Moves to strengthen ties in Asia (since 1996) and active efforts to promote Asian organizations that exclude the United States (since 2001) reflect a desire to deny Washington regional support for any potential attempt to contain China or to intervene in a Taiwan conflict. Chinese efforts to build or strengthen strategic partnerships with Russia, key European countries, and emerging powers such as India have intensified since 2001 to prevent their participation in any potential U.S. effort to contain China and to encourage them to play a more independent international role.

The economic track is driven primarily by development needs and China's changing role in the world economy. China's increasing demand for economic inputs and access to export markets follows a logic and geography independent of strategic concerns. Beijing has become increasingly dependent on exports to and investment from developed countries—even countries such as the United States and Japan that its leaders regard as potential threats—to maintain economic growth. The need to secure access to oil, natural gas, and other resources has prompted aggressive efforts by state-owned firms, supported by state economic and diplomatic resources, to purchase resources or establish long-term supply contracts. Resource access has led China to build close relations with questionable regimes such as Iran, Sudan, Angola, and Burma.

The dramatic increase in Chinese activity in the Middle East, Africa, Latin America, and (to a lesser degree) Central Asia since 2001 reflects efforts to acquire resources and build export markets in developing countries. Many countries in these regions share China's interest in resisting U.S. efforts to promote democracy and to intervene in other countries. Domestic competition is also pushing Chinese companies overseas.

China's economic and strategic objectives sometimes conflict, while policies are implemented by government and business actors whose interests often clash with each other and with central

government objectives. When strategic concerns threaten to interfere with economic growth, Chinese leaders have repeatedly compromised or pursued policies that allow growth to continue. Chinese policy toward Taiwan conforms to this pattern, although Beijing would likely use force to prevent Taiwanese independence despite the economic costs. Campaigns such as the “go global” campaign, economic and political incentives, and mechanisms such as senior leadership travel are used to try to coordinate government and business efforts and to resolve internal conflicts. Efforts at policy coordination have produced some impressive tactical successes, such as Hu Jintao’s 2004 trip to Latin America. However, conflicts of interest and personal incentives often lead companies, ministries, and local leaders to evade government directives and to pursue their own interests at the expense of central government goals.

China exercises influence through a variety of tools. Economic and diplomatic tools are the most important, with security assistance playing an important role in some regions and with some countries. Soft power and military power are less effective instruments of Chinese power (and may be negative factors in dealing with some countries).

Since 2001, China has significantly increased its commitment of resources to improving relations with key countries and regions. Leadership travel, outbound foreign direct investment (FDI), development assistance, and trade ties have all increased dramatically, and are likely to increase further in the 16th 5-year program (2006–2010). China’s FDI and development assistance efforts are modest compared with U.S., European Union, and Japanese programs, but China uses them effectively and strategically to advance its interests. Recent commitments to increase FDI and development assistance to Africa, Latin America, and the Middle East are much larger than historical levels. China probably significantly increased resources allocated to these activities in its 2006 5-year program. The pattern of actual resource allocation reflects both strategic interests (in relations with great powers and Asian countries) and economic interests (in securing resources and expanding markets in Asia, Latin America, Africa, and the Middle East).

Beijing has taken advantage of opportunities created by the U.S. focus on terrorism, the unpopularity of some U.S. policies (especially in the Muslim world), and by relative U.S. neglect of Latin America, Africa, and Southeast Asia to expand its influence in these areas. However, a backlash is developing as Chinese goods displace local products, the Chinese commercial and labor presence produces frictions with local workers, and heightened expectations for Chinese investment and development assistance are not fulfilled. China’s increased influence should be kept in perspective. Chinese military power projection capability remains limited. Chinese businesses are taking their first steps in efforts to become global multinationals, and 60 percent of China’s exports are currently produced by foreign-invested firms. China still operates within the framework of global institutions established by the United States.

Introduction

China’s leaders have achieved remarkable success in building a booming economy and holding their political system together for 15 years after communism collapsed in Eastern Europe and the Soviet Union. Although prospects for continued growth are good, Chinese leaders confront an international system dominated by the United States and a globalized world economy where sophisticated multinational corporations possess technology and management skills decades ahead of their Chinese competitors. China also faces a host of domestic challenges, ranging from the environmental degradation produced by headlong growth to social tensions created by rising inequality between coastal

and interior provinces and between rural and urban workers. A senior public security official recently admitted that there were more than 74,000 mass protests involving 3.7 million people in 2004.¹

The party's response emphasizes efforts to alleviate social pressures by reducing the tax burden on rural residents and devising economic policies that will produce more balanced growth with fewer negative side effects. This represents an adjustment from previous policies focused on maximizing growth rates, but Chinese leaders will still emphasize the importance of continued rapid economic growth for maintaining domestic stability and attaining long-term policy goals. A prolonged economic downturn or slowdown in growth would aggravate social problems and likely stimulate increased protests.

Economic imperatives and strategic challenges are leading China to expand its international activities into different regions of the world. This paper analyzes the rationale and drivers for China's increased global activism; examines the tools China is employing and how they are being used; assesses the empirical evidence about priorities and patterns in China's global activities; and considers whether these activities reflect an underlying strategic design. The paper concludes with an overview of likely future developments and an assessment of the implications for the United States.

Grand Strategy, Economic Development, and Foreign Policy Priorities

Over the last 25 years, economic reforms have transformed the Chinese system from a backward and isolated economy run by inefficient central planning mechanisms into a large and rapidly growing economy driven primarily by market forces and increasingly integrated into a globalized world. This process has been uneven and has reflected experimentation, openness to outside economic advice, and pragmatic decisionmaking rather than a coherent master plan.² The Chinese government has opened its economy to foreign investment and international competition, eased social controls over its population, and reduced the state's role in the economy as foreign, private, and collectively-owned firms account for an increasing share of production.

Beijing's economic reforms (and broader foreign policy) reflect both a relatively coherent grand strategy for building China into a wealthy and powerful state and a domestic strategy for ensuring the continued rule of the Chinese Communist Party. The grand strategy stresses the need for a stable international and regional environment in which China can modernize its economy and improve its relative power position. Deng Xiaoping's 1985 declaration that the world had entered a new era of "peace and development" provided a political justification to reduce defense spending and focus on economic development. China improved relations with other major powers and made strategic compromises to preserve an international environment conducive to development. Its relative economic backwardness and low technology base mean China will need an extended period of time to catch up with other great powers. Developing the capacity for indigenous technology innovation will be difficult and will likely require significant changes in China's industrial structure.³ But over the long term, Chinese leaders hope to develop the economic and technological foundations that will create a rich and powerful country.

This international grand strategy has been accompanied by domestic efforts to build new sources of political support for the Communist Party as belief in Marxist ideology has eroded. This need became acute after the 1989 Tiananmen massacre and the collapse of communism in Eastern Europe and the Soviet Union. Chinese leaders have emphasized the importance of rapid growth as

a strategy for regime survival, with the goal of rebuilding legitimacy by demonstrating the party's ability to build an advanced economy and to raise living standards. Leaders have also sought to build and appeal to Chinese nationalism.

When strategic concerns or foreign policy conflicts have threatened to interfere with the conditions necessary for growth, Chinese leaders have made pragmatic compromises to keep the economy expanding. China has welcomed trade and investment from politically suspect sources, including Western democracies, Japan, and political rival Taiwan. Despite suspicions that the United States seeks to subvert China's political system, leaders have welcomed U.S. investment and become increasingly dependent on exports to the United States. When the United States used renewal of China's most-favored nation status to press for human rights improvements in the 1990s, China grudgingly made the concessions necessary to maintain trade ties. China has also curtailed nuclear cooperation with countries such as Iran and Pakistan and reduced or eliminated assistance to Syrian, Iranian, and Pakistani missile programs in response to U.S. pressure.

Despite increased fears of movement toward Taiwanese independence since 1999, China has not responded to assertions of sovereignty by Taiwan political leaders with force and has tolerated increased U.S. arms sales and security cooperation with Taiwan. Chinese leaders appear to recognize that a military conflict with the United States over Taiwan would have severe consequences for China's economic modernization (and thus on internal stability). Similarly, when anti-Japanese sentiment has escalated to a point where it threatens economic ties, Chinese leaders have suppressed protests at some domestic cost. Examples include protests over the disputed Diaoyu/Senkaku Islands in 1990, 1996, and 1999.⁴ The Chinese government tolerated March 2005 street demonstrations against Japan, but moved to contain the protests when they began to threaten Japanese businesses. Shanghai city leaders subsequently assured Japanese businessmen that the government would protect their interests.⁵

Strategic and Economic Drivers of Increased Global Activism

Over the last 15 years, Chinese international economic interests have expanded, and Chinese foreign policy has become more active in response. The timing and pattern of China's increased involvement in different regions of the world have evolved along independent strategic and economic dimensions.

The strategic track is driven primarily by international threats and opportunities and China's changing role in the global balance of power (and especially its relationship with the United States). China's relative weakness and the possibility of hostile action by the United States for purposes of containment or subversion are persistent concerns for Chinese leaders.

The economic track is driven mainly by economic development and China's changing role in the world economy. Increasing demand for inputs such as capital, technology, natural resources, and management expertise and for access to markets follows a logic and geography independent of strategic concerns. Despite Chinese strategic worries about the United States and Japan, economic ties with both countries have deepened steadily over the last 15 years, with China becoming increasingly dependent on exports to those nations.

Coordinating these competing strategic and economic demands is a central challenge for Chinese policymakers, who see important roles for the state in helping the economy to develop. Given intense international competition for energy and other natural resources, they believe national firms need state assistance to secure access to resources. China's position as a latecomer to international

resource markets and the economy's surging demand for inputs make resource access critical for sustaining economic growth. Chinese leaders regard commercial diplomacy as an effective means of leveraging political ties to secure access to resources and expand export markets. Many also believe the state can intervene in the market successfully by providing incentives and subsidies to help achieve goals such as securing access to resources, upgrading the technology capability of firms, and increasing the value-added component of exports.

Balancing Economic Opportunities and Strategic Concerns

Efforts to balance strategic threats and the demands of economic growth have been a constant thread of Chinese foreign policy since 1989. Economic considerations generally have taken priority, but developments such as the end of the Cold War have also prompted increased Chinese activism in some countries and regions. Foreign policy objectives over the last 15 years can be divided into three broad periods.

Overcoming Post-Tiananmen Isolation and the End of the Cold War (1989–1996). Chinese leaders sought to end diplomatic isolation and ward off economic sanctions. Japan and Southeast Asian countries played a crucial role in supporting China's reentry into the international community. The end of the Cold War and the disintegration of the Soviet Union allowed China to establish relations with anti-communist countries such as South Korea, Indonesia, and South Africa and to become active in Central Asia and the former Soviet Union to deny Taiwan diplomatic opportunities. Widespread international recognition of China's economic potential in 1992–1993 facilitated Chinese efforts to expand diplomatic and economic ties. This period ended in 1996 as Beijing's military encroachments in the South China Sea and 1995–1996 missile diplomacy in the Taiwan Strait created fears that a strong and reckless China might destabilize Asia.

Reassuring Asian Neighbors and Building Constructive Relations with the United States and European Powers (1996–1999). Beijing responded to widespread concerns about a "China threat" by moderating its approach to territorial disputes in Asia and seeking to improve ties with Washington and European capitals.

China's approaches to Asia were generally successful and reciprocated. China stressed "omni-directional diplomacy" to build stable relations with neighboring countries in Asia (including resolving most land border disputes, sometimes via territorial concessions). Beijing earned plaudits during the Asian financial crisis for maintaining the value of its currency and offering financial assistance. Association of Southeast Asian Nations (ASEAN) countries welcomed China into regional organizations and dialogues as part of a conscious strategy of engaging and entangling Beijing in a web of multilateral institutions. For its part, China learned to practice multilateral diplomacy effectively (including new initiatives such as the regional consultations that produced the Shanghai Cooperation Organization).

China's restrained behavior and the lure of its market helped repair relations with Europe, but efforts to build a constructive strategic partnership with Washington via summit diplomacy collapsed in 1999 amid accusations of Chinese nuclear espionage. North Atlantic Treaty Organization intervention in Kosovo, the accidental bombing of China's embassy in Belgrade (which many Chinese believe was deliberate), a reinvigorated U.S.-Japan alliance, Taiwan's efforts to assert its sovereignty, and U.S. efforts to develop ballistic missile defenses all highlighted the possibility of a confrontation with the United States.

In 1999, Chinese analysts debated whether these developments marked an end to the "era of peace and development" that required fundamental changes in Chinese policy. This debate ended with

the leadership's formal reaffirmation of the peaceful nature of the international environment.⁶ However, this decision was hedged by intensified efforts to build Chinese military capabilities, including annual double-digit real increases in Chinese military budgets.

Dealing with U.S. Hegemony (1999–Present). Despite deep suspicions about the intentions of the United States, China was depending increasingly on access to the U.S. market and needed America's support for entry into the World Trade Organization (WTO). Beijing wrestled with several different approaches to its Washington problem.

China's 1999–2001 diplomatic campaign to mobilize international opposition to U.S. ballistic missile defenses and potential withdrawal from the Anti-Ballistic Missile Treaty ended in failure when European countries refused to confront the United States and Moscow cut a deal with Washington on strategic arms reductions that ignored Chinese concerns. This campaign represented an attempt to mobilize other great powers to counterbalance American power.

Chinese leaders recognized that a coalition to restrain the United States was infeasible because of the high value other great powers placed on cooperation with Washington. They decided that China must reach an accommodation with the United States and communicated their intention to improve relations with the next U.S. administration to U.S. Asia policymakers in fall 2000.

Beijing's efforts to stabilize ties with Washington were facilitated by the 9/11 attacks, which refocused U.S. attention on terrorism and increased the value of security cooperation with China (including on managing the North Korean nuclear crisis). China made a number of policy adjustments to stabilize and improve bilateral relations with the United States. Beijing tolerated increasing U.S. security cooperation with Taiwan, especially after the Bush administration demonstrated that it would act to restrain moves toward Taiwan independence. Chinese analysts regard President Bush's December 2003 public statement alongside Chinese Premier Wen Jiabao that the United States opposed any Taiwan comments and actions that challenged the status quo as a particularly significant U.S. commitment.⁷

Although China opposed U.S. and British efforts to enforce Security Council resolutions in Iraq through military means, Beijing rejected entreaties from France and Germany to take the diplomatic lead in opposing the Iraq war.⁸ Chinese officials have also sought to reassure Washington that China regards the U.S. military presence in Asia as a stabilizing factor and does not seek to push the United States out of Asia.

Stabilizing relations with the United States has been a key part of China's foreign policy, but China has also made increased efforts to strengthen ties with other countries wary of perceived U.S. unilateralism and disregard for international norms. In 2001–2002, China established strategic partnerships with major European countries and began to repair ties with India. China also deepened economic and political ties within East Asia via its relationship with ASEAN and the ASEAN + 3 (China, Japan, and South Korea) grouping.

After entering the WTO in November 2001, China refocused its economic diplomacy on the tasks of securing access to energy and other resources, building competitive international companies, and opening developing country markets to Chinese goods and investment. This led to a major increase in Chinese resources devoted to Africa, Latin America, and the Middle East.

U.S. distraction and neglect have created opportunities for an increased Chinese diplomatic and economic role in Latin America, Africa, and Southeast Asia. U.S. efforts to promote democracy in the Middle East and perceived anti-Islamic actions in prosecuting the global war against terrorism have made China's nonpolitical approach relatively attractive. Countries such as Iran, Saudi Arabia, and Syria view China as a potential means of resisting U.S. economic and political pressure. Beijing has also

found many developing countries willing to cooperate in quiet efforts to defend the principle of sovereignty, to resist U.S. efforts to assert a right to democratic governance, and to oppose U.S. intervention.

Drivers of China's Increasing Global Activism

The previous section described how China's grand strategy of maintaining a peaceful international environment to pursue economic development and its domestic strategy of using rapid growth to rebuild domestic support for the Chinese Communist party prompted an expansion of Chinese economic and diplomatic activity across different countries and regions. Four specific motivations stand out as key drivers of increased Chinese global activism: securing inputs for the economy; protecting against a potential U.S. containment strategy; expanding Chinese political influence; and pursuing Chinese commercial interests.

Securing Inputs for the Economy

One key driver of China's global involvement is the need to secure access to energy and other resources necessary for continued economic growth. Imports to fuel China's rapid growth in 2003–2004 are the major cause of large jumps in the world prices of commodities such as copper, steel, iron ore, cement, and aluminum, and a contributing factor in higher oil and gas prices. Senior Chinese leaders have highlighted energy security as an essential issue for China's future.

The Chinese energy debate focuses both on supply security and on the need to keep energy prices as low as possible.⁹ Chinese leaders appear to recognize the need for market-oriented energy prices to spur increased energy efficiency, but concerns about the negative impact on economic growth and employment have impeded efforts to move completely to market prices. China has begun construction of a strategic oil reserve as part of efforts to increase energy security. The choice of above-ground storage facilities suggests leaders are more concerned about supply disruptions rather than hostile military action. China has delayed purchases to fill its first completed storage facilities due to high international oil prices.

China's economy makes relatively inefficient use of energy, using about three times as much energy per dollar of gross domestic product as the United States. Continued growth, coupled with increased use of automobiles, will make China increasingly dependent on imported oil and gas supplies. International Energy Agency projections suggest Chinese oil imports will rise from the current level of 6.37 million barrels per day (bpd) to roughly 14 million bpd by 2030. By 2030, China will depend on imported oil for approximately 75 percent of its total demand, with supplies coming mainly from the Persian Gulf.¹⁰ Demand for natural gas is also projected to increase dramatically, though coal will remain China's primary energy source.

A growing trade surplus and ample foreign currency reserves allow China to pay for imported energy, but leaders are reluctant to rely on international markets to secure access to energy and critical inputs. This reflects suspicions that the United States and other Western countries dominate the world economy and can use their economic power to deny China access to energy and other materials. The 1997–1998 Asian financial crisis, when countries such as Indonesia and South Korea were punished by financial markets and forced to make policy concessions to secure assistance from the International Monetary Fund, increased China's emphasis on "economic security" in its thinking about globalization. The fifth plenum communiqué issued in October 2005 highlights increasing global competition for resources as a key international trend.

The preferred approach to resource security is for Chinese firms (usually state-owned enterprises) to own equity in the resource. This provides access in times of scarcity and gives some protection against price shocks (if the government can persuade firms to supply resources to customers at below-market prices). Chinese enterprises have been willing to purchase minority equity shares and to enter into joint ventures to gain access to resources. In cases where equity is not available, China has pursued long-term supply contracts (which typically guarantee supply but charge prevailing market prices). Its long-term oil and gas supply contracts with Iran are examples.

The geographical distribution of energy and other resources dictates where China must go to secure supplies. As late entrants to the market, Chinese firms face conditions where the best resource supplies are often committed to long-term contracts or being exploited by nationally owned firms. Chinese companies are therefore drawn to sites where political conditions limit competition by Western multinationals (such as Iran, Sudan, and Angola) or where resources are difficult or expensive to recover. However, Chinese firms often lack the advanced technology necessary to exploit some available oil and gas deposits.

Increasing dependence on imported energy and resources (and the need to transport large quantities of export goods to trade partners) makes China heavily dependent on reliable transportation, with sea lines of communications (SLOCs) particularly important. Tankers carrying oil and gas to China from the Middle East travel through the narrow Malacca Strait, where they are vulnerable to piracy and the possibility of terrorist action. China must also reckon with the U.S. Navy, which has global reach and the potential ability to interdict China's energy and trade routes. The People's Liberation Army (PLA) Navy has only limited power projection capability and lacks the ships and overseas bases necessary to sustain a naval presence, let alone control, over the SLOCs that are vital to Chinese economic prosperity.¹¹ Chinese naval strategists have written extensively about this vulnerability.

Protecting Against a Possible U.S. Containment Strategy

A second motivation is to deny the United States the ability to contain China. Many People's Republic of China (PRC) elites see the United States as practicing a strategy of "soft containment" that seeks to limit China's power and subvert its political system. Recent examples cited by Chinese analysts include Washington's interventions with the European Union to delay a planned lifting of the arms embargo against China and efforts to cut off the flow of military technology from Israel. By building good political relations and strong economic ties with neighboring countries and other great powers, Beijing hopes to deny Washington partners in any potential future effort to contain China.¹²

Geography and relative power dictate the focus of these efforts. China is most concerned about bordering countries that could provide a foothold for U.S. military actions. This partly explains Chinese neuralgia about the U.S. military presence in Central Asia (and intensifies concerns about U.S. security ties with Taiwan). China has paid particular attention to key U.S. allies in Asia: Thailand, the Philippines, and Australia have all hosted high-level visits by Chinese leaders and received significant Chinese foreign investment or economic assistance.

This objective dictates efforts to build strategic partnerships with other great powers and potential power centers:

- *Russia.* Beijing's strategic partnership with Moscow emphasizes cooperation as a means of balancing U.S. power. Russian arms sales and technology transfers are key components of the relationship, but events such as the August 2005 "Peace Mission" joint exercise are intended

to convey the relevance of the strategic partnership to regional and global security issues. Activities in the exercise (which included amphibious assault training) and extensive press coverage suggest Chinese efforts to raise the perceived costs of U.S. and Japanese involvement in a Taiwan conflict.

- *Europe.* China has used market access, infrastructure contracts, and purchases of high-value products such as airliners to strengthen ties with key European countries. Beijing has also used the Asia-Europe Meeting and bilateral diplomacy in efforts to build a strategic partnership with the European Union.
- *India.* Beijing has used high-level dialogue and economic cooperation to improve ties with New Delhi since 2001. Despite an unresolved border dispute and concerns over India's strategic ambitions, China has emphasized joint interests in promoting economic opportunities for developing countries and limiting U.S. global influence.

China's international efforts to protect against possible U.S. containment activity rely mostly on political actions, but also involve attempts to acquire advanced military technologies and to expand Chinese intelligence collection capabilities. Technology acquisition efforts focus primarily on Russia, Western Europe, the United States, and Israel. (U.S. efforts to disrupt the longstanding flow of military and dual-use technology from Israel to China are likely viewed as part of a U.S. containment strategy.) Although China does not have overseas military bases, Chinese firms have supported the expansion of port facilities in Pakistan and Burma that may have a contingency role for Chinese naval activities. China reportedly supports signals intelligence collection facilities in Cuba and Coco Island (in the Indian Ocean) and operated satellite tracking facilities in Kiribati (reportedly closed following the government's shift of diplomatic recognition of Taiwan), South Asia, and Namibia.¹³

Expanding Chinese Political Influence

In addition to its traditional emphasis on great power diplomacy, Beijing invests resources to build ties with small countries whose principal value lies in their votes in the United Nations (UN) General Assembly and other international meetings or organizations. China's growing involvement in the South Pacific and with smaller African countries is a prime example. China has a range of motives for building political influence with countries in various regions of the world.

Isolating Taiwan. Efforts to achieve unification with Taiwan are central to Chinese foreign policy. China's global competition with Taiwan for exclusive diplomatic recognition is a zero-sum game. The 25 countries that formally recognize Taiwan (mainly small countries in Latin America, Africa, and the South Pacific) and other countries

Island Fever

While the United States and its allies have gradually scaled back their involvement in the South Pacific since the early 1990s, China has been increasing its presence. China now has eight embassies in the South Pacific (including a care-taking group in Kiribati) and the largest number of diplomats in the region.

The South Pacific is a key battleground in the China-Taiwan contest for diplomatic recognition. Eight of the fourteen Pacific Islands Forum members recognize the People's Republic of China; six recognize Taiwan. Many of the countries have flip-flopped over the years.

Beijing has showered countries with major infrastructure and assistance projects from a US\$5.5 million sports complex in Kiribati to the donation of 2 cargo ships worth US\$9.4 million to Vanuatu. Commercial deals emphasize natural resources needed in China (such as minerals, timber, and fish), while providing much needed investment for the South Pacific. Agreements include a US\$625 million nickel and cobalt mine in Papua New Guinea and millions to upgrade a Cook Islands fishing and processing plant.

China is a major donor to the Pacific Islands Forum and the highest paying subscriber to the South Pacific Tourism Organization. In addition to votes in the United Nations, the South Pacific has strategic value to China. In 1997, China established a satellite-tracking station in Kiribati. Ostensibly tied to China's space program, the station may have been used to spy on U.S. bases in the Marshall Islands. The station was dismantled following Kiribati's diplomatic defection to Taiwan in November 2003. Beijing is reportedly looking for another place in the region to use as a new base of operations.

potentially susceptible to financial enticements from Taipei to switch diplomatic recognition receive special attention from Beijing.

China's diplomatic efforts to isolate Taiwan include limiting participation by its representatives in international economic meetings such as the Asia-Pacific Economic Cooperation (APEC) forum; mobilizing international opposition to its annual efforts to join the United Nations and to participate in the World Health Organization; and soliciting statements of support for the "one China principle" from countries that recognize the PRC.

Protecting Chinese Interests from Adverse International Actions. The prototypical example is China's effort to prevent the UN Human Rights Commission from considering resolutions critical of human rights conditions in China. Throughout the 1990s, Beijing built diplomatic coalitions and lobbied developing countries to prevent debate on human rights conditions in China. Its successful efforts to exempt developing countries from binding obligations under the Kyoto Protocol and to organize opposition to Japanese efforts to join the UN Security Council are also examples.

Advancing Chinese Diplomatic Goals. China's campaign to enter the WTO in the late 1990s illustrates efforts to use political influence on behalf of specific policy objectives. Since 2004, Beijing has sought to persuade countries to declare China a "market economy" not subject to stringent anti-dumping actions under WTO rules. Beijing has practiced "ricochet diplomacy," using declarations by small countries to press large trading partners to recognize China as a market economy. For example, Singapore and Malaysia's declarations of China's market economy status in May 2004 were used to press other ASEAN states to follow suit, which they did at the China-ASEAN summit in Laos in November 2004. China is using its recognition as a market economy by 37 countries to press the European Union for a similar status.

Limiting Japan's International Role. The legacy of Japanese imperialism and a growing sense of regional rivalry stoke Chinese fears that Japan will become a normal country with military capabilities to match its economic and technological prowess. Beijing regularly cites this history to oppose Japanese efforts to relax restraints on its military capabilities and activities and to play a larger role in regional and global affairs. China supports the U.S.-Japan security alliance so long as it restrains Japan, but fears the alliance might play a negative role in efforts to achieve Taiwan unification. Japan's power and economic presence in Asia are seen as obstacles to greater Chinese regional influence.

Pursuing Commercial Interests

Commercial interests are also an important rationale for Chinese global involvement. PRC authorities regard rapid economic growth as critical for maintaining social stability, so helping firms pursue commercial opportunities overseas is seen as advancing national goals. Leaders have sought to use China's openness to foreign investment to acquire technology and management expertise and to use competition from foreign firms operating in China to prepare Chinese companies to compete in the global economy. Three objectives are prominent:

Opening New Markets for Chinese Goods and Labor. China's development strategy has emphasized exports to major developed country markets such as the United States, Japan, and Western Europe. Exports to these markets have grown rapidly but are beginning to stimulate protectionist reactions. China has sought to diversify and develop new export markets, paying particular attention to developing countries in Asia, Latin America, and Africa.

This effort reflects a variety of government and firm motivations:

- Infrastructure construction in foreign countries increases Chinese access to resources and employs Chinese workers. Some construction reportedly may be subsidized or encouraged by the Chinese government to build political influence in particular countries.
- Improvements in port, road, river, and rail transportation networks in Southeast Asia help develop southwest China, improve access to regional markets, and create alternate pathways for energy and goods that bypass potential chokepoints in the Malacca Straits.¹⁴
- Individual firms that lack the technology or management skills to compete successfully in domestic markets can use exports or investment in less competitive developing markets as a survival strategy. Surveys of Chinese firms cite intense competition in the China market as an important motivation for outbound foreign investment.¹⁵ The chief executive officer of Haier has noted, "Every multinational [has] set up in China. Margins are low here. If we don't go outside, we can't survive."¹⁶

Building National Champions, Brands, and Distribution Networks. Chinese exports are booming, but about 60 percent of them are produced by foreign funded enterprises based in China.¹⁷ The percentage is even higher in high-tech sectors such as industrial machinery (79 percent), computers (92 percent), and electronics and telecommunications (74 percent).¹⁸ Many Chinese companies are locked into low value-added niches in global supply chains with limited opportunity to innovate or earn large profits.¹⁹

Chinese policymakers want to build national companies that can compete internationally. This was one motive behind the "grasp the big, let go of the small" approach to privatizing state-owned enterprises. Chinese companies such as Haier, TCL-Thompson, and Lenovo have all recently pursued acquisitions of foreign businesses in order to acquire internationally recognized brands and access to established distribution networks.

Haier, China's leading home-appliance manufacturer, has faced increasingly tough competition in the domestic market, which accounts for 80 percent of its sales. Haier has had zero profit growth for the last 3 years, which led executives to expand further into the U.S. market. Weaknesses in design skills, distribution, and service networks limited Haier's success and prompted the company to make a \$1.28 billion bid in 2005 to purchase Maytag. Haier sought Maytag's brand name and sales network, but ultimately was outbid by Whirlpool.

Chinese computer maker Lenovo purchased IBM's personal computer business in December 2004 for \$1.75 billion. The acquisition was motivated by increasing competition and falling profits in the domestic market, and by Lenovo's desire to acquire an internationally recognized brand name that would allow it to compete effectively at the global level.²⁰

Acquire Advanced Technology. Chinese firms also seek to use acquisitions or joint ventures to obtain technology necessary to improve their competitive ability. Joint ventures with foreign firms investing in China have been a primary means of acquiring technology in the past, but China's WTO commitments now allow foreign firms to establish wholly owned subsidiaries (thus avoiding the need to share technology with Chinese partners). This provides increased incentives for Chinese firms to pursue technology by acquiring foreign companies. For example, Huawei, a major Chinese telecommunications manufacturer, has expressed interest in purchasing the British firm Marconi.²¹ Shanghai Automotive Industry Corp (SAIC), a leading Chinese auto manufacturer, purchased Korean automaker Ssangyong Motors for \$500 million in October 2004. Access to the Korean firm's technology and research and development capability was an important motive for the deal.²²

Beijing also seeks technology through other channels. China has signed technology sharing agreements with more than 52 countries, including Russia, Israel, and major Western European countries. These agreements provide channels for China to acquire technology legitimately. China also acquires advanced technologies illegally, either through organized espionage or from individuals who know that bringing commercially valuable technology to China will be helpful in securing employment.²³

Tools for Chinese Global Influence

China employs various tools to exercise influence in different regions of the world. Economic and diplomatic tools are the most important, with security assistance playing an important role in some regions and with some countries. China's success in achieving rapid economic growth without political liberalization may eventually become a source of "soft power" if it inspires emulation by other authoritarian regimes. China's limited power projection capabilities make military power only a minor tool of influence outside Asia, but PLA military capabilities matter greatly inside the region.

Beijing cannot necessarily use all these tools in a coordinated manner. The stovepiped bureaucracy in China complicates coordination across ministerial boundaries and between the center and local governments. Some tools (such as development assistance, diplomatic initiatives, and security assistance) are under direct central government control. Others (such as trade and foreign investment) are influenced by economic factors, implemented by independent actors, and only partially subject to direction through incentives and administrative controls. Some potential tools such as soft power and military power may have negative side effects. To address some of these issues, China organized a major internal meeting on "Economic Diplomacy Toward Developing Countries." Held in August 2004, the meeting reviewed existing cooperation programs, sought to improve coordination, and outlined a work plan for expanding economic and political cooperation with developing countries.²⁴ Despite these efforts to improve policy coordination, it would be a mistake to assume that all activities of Chinese entities are under central government control.

Economic Tools

China is an avid practitioner of commercial diplomacy. In addition to using diplomatic efforts to advance the economic interests of the country and its companies, Beijing also seeks to leverage economic ties on behalf of Chinese diplomatic and strategic objectives. Trade, outbound foreign investment, and foreign aid are particularly important tools.

Trade. China's booming exports have created a parallel growth in imports, as Chinese firms import capital goods and raw materials and multinational corporations ship in parts and components for assembly in Chinese factories. As living standards and disposable income rise, China's domestic market is also increasingly attractive to foreign companies.

Chinese imports are fueling growth throughout Asia and in other regions of the world. For example, in 2003, China became the largest export market for Japan, South Korea, and Taiwan. The China market is credited with helping to revive the Japanese economy from its decade-long slump. Chinese imports of energy and other resources are driving commodity prices and have given a major boost to commodity exporters in Africa and Latin America. In 2004, exports to China increased by 45 percent in South Africa, 71 percent in Brazil, and 48 percent in Panama. The appendix illustrates how dependence on the China market has increased in different regions and countries.

The Chinese government has long used market access and purchases of foreign goods as diplomatic tools, especially when dealing with developed countries. During U.S. debates over renewal of China's most-favored nation status in the early 1990s, China sent purchasing delegations to buy billions of dollars' worth of U.S. goods prior to key Congressional votes. This tactic was revived in April 2006, when Chinese President Hu Jintao's visit to Washington was preceded by a stop in Seattle where Chinese companies signed \$16 billion worth of contracts. Beijing has also used large infrastructure contracts and major purchases (such as commercial aircraft) to reward or punish countries for their policies toward Taiwan.

China's increasing role in world trade (and expectations of future growth) makes it an attractive market and gives Beijing leverage in dealing with trade partners. Chinese leaders and analysts appear to believe that trade dependence can generate significant political influence as groups that benefit from trade mobilize to protect their economic interests. However, these groups do not necessarily exert a dominant influence within other countries. For example, Japanese business groups have called for better Sino-Japanese relations, but this has not been sufficient to outweigh other Japanese groups seeking a more assertive policy toward China.

Two new elements recently have emerged in China's trade strategy. One is an increased focus on developing countries as trade partners. Even in cases where Chinese products and technologies are not state of the art, they may be well suited for developing country markets, especially if Chinese companies are willing to import other goods in return. An August 2004 internal conference highlighted the importance of expanding Chinese trade with developing countries and the need to "regulate and guide behaviors of Chinese enterprises in their market penetration in developing countries."²⁵

A second element is China's efforts to negotiate regional and bilateral free trade agreements. China's agreement with ASEAN is the most significant example, but China is currently discussing bilateral agreements with Australia, New Zealand, Japan, South Korea, Chile, India, and others.²⁶ Chinese officials also regularly use trade-facilitation agreements or non-binding bilateral trade targets to leverage market access as a diplomatic tool in bilateral relations.

Investment. China is a major FDI destination for multinational corporations, hosting \$622.3 billion as of the end of 2005.²⁷ China significantly liberalized regulations on inbound FDI as part of its WTO entry negotiations, but the government still seeks to use the approval process to obtain technology transfers, establish research and development facilities in China, and increase production of high-technology and high-value-added products. Willingness to facilitate or obstruct major projects can be an important tool in dealing with investors in the United States, Europe, and Asia. (However streamlined procedures that delegated approval to provincial or city officials have reduced the central government's ability to employ this tool.)

China is also becoming increasingly important as a source of outbound FDI. The "go global" campaign launched in the late 1990s encourages both state-owned enterprises and smaller private and collective enterprises to invest abroad. The "go global" strategy was highlighted in work reports at the 2003 National People's Congress and promoted at Chinese business conferences in 2004. The government subsequently streamlined FDI approval procedures and developed lists of target countries and sectors where investment is encouraged.²⁸ The China Import-Export Bank and China Construction Bank likely provide subsidized loans for Chinese companies investing in priority countries or functional areas such as resource acquisition.

As of the end of 2005, China's officially recorded total outbound FDI was \$43.9 billion.²⁹ This figure omits some types of outbound FDI and probably significantly understates the total

amount. About \$25 billion of this total is reportedly invested in Hong Kong.³⁰ Developing countries welcome Chinese FDI as a means of building their economies and infrastructure. It is a particularly useful tool in countries where Western companies are reluctant to invest due to economic conditions or political risk.

Foreign Aid. Development assistance has been an important part of China's foreign policy since the 1960s, when China competed with the Soviet Union and the United States for political influence in Africa. As a significant recipient of international assistance, China has downplayed its spending on development assistance. However, aggregate figures have been released since 2003: China's external assistance (in \$U.S. millions) for 2002 was \$602.77; for 2003 was 630.36; and for 2004 was \$731.20.³¹

Train in Vain?

Philippine President Gloria Macapagal Arroyo's September 2004 state visit to China was hailed as a major success. One highlight was Beijing's agreement to finance the first phase of the North Rail project, a 32.2 kilometer railroad line from Metro Manila to Malolos City. The China Export-Import Bank provided a \$400 million dollar loan that covered 95 percent of the total cost, at a special concessional interest rate of 3 percent over 20 years.

Critics have cited the deal in impeachment complaints against President Arroyo, claiming the no-bid contract awarded to China National Machinery and Equipment Corp (CNMEC) was the product of corruption. The Arroyo administration claims the project is a state-to-state agreement exempt from public bidding.

Although highly rated as a construction company, CNMEC has no experience building railways. Questions have been raised as to cost and why the line extends to Malolos City, a relatively uncongested commute, instead of burgeoning Angeles City. The project may have won China friends in the Arroyo administration but is unlikely to win much goodwill with the broader public.

China also provides development assistance in the form of subsidized loans. These are typically financed through the China Import-Export Bank for industrial or infrastructure projects. Financing requires most of the loaned money to be spent on Chinese materials and labor for the project. The China Import-Export Bank's annual report does not provide the total amount spent on concessional loans. The bank reportedly received \$5 billion in July 2005 from the State Administration of Foreign Exchange to finance its policy operations.³² The China Import-Export Bank's operations, including its role as a conduit for development assistance, may expand significantly in the 2006 5-year program.³³

Chinese development assistance typically lacks the political and economic conditions that accompany aid from the World Bank or Western countries. China does not impose human rights conditions, require rigorous cost-benefit analysis, or emphasize anti-corruption measures to ensure that funds are spent properly. Many projects, such as construction of stadiums in Africa, have limited economic returns. In some cases, purchasing influence by funneling money to foreign leaders may be China's primary motive.

These relatively modest expenditures for development assistance and outgoing foreign investment are out of proportion with the multibillion dollar commitments Chinese leaders have made to foreign countries over the last several years. This may indicate that official figures for development assistance and foreign investment are too low, that other (unreported) channels are used to approve and convey development assistance, or that Beijing will be unable to fulfill many of its commitments.

Currency. Foreign currency reserves allow a country to exert some influence over the relative value of its currency (and potentially over the values of the currencies of other countries). China's decision in 1997 not to devalue its currency during the Asian financial crisis allowed affected Asian countries to benefit from increased exports as their currencies depreciated, winning China praise from other Asian countries for its responsible behavior. China has currency swap arrangements with Thailand, Malaysia, Indonesia, South Korea, and the Philippines as part of the Chiang Mai initiative. These bilateral arrangements provide countries with liquidity in the event of a balance of payments crisis.

Until July 2005, China pegged the value of its currency to the U.S. dollar, which produced a decline in the *yuan's* value relative to European and other Asian currencies as the dollar has declined. Other countries (including U.S. manufacturers) have complained that the *yuan* is undervalued, giving Chinese exporters an unfair trade advantage. China's \$853 billion foreign currency reserves (as of February 2006) are mainly invested in dollar-denominated U.S. Government securities.³⁴ China has purchased large quantities of U.S. assets to maintain its currency peg with the dollar, in effect helping to underwrite the U.S. trade deficit. If China were to sell large quantities of U.S. securities, it could cause the value of the dollar to fall, but would negatively affect the value of its own holdings (and also reduce the volume of Chinese exports to the United States).

Diplomatic Tools

A striking aspect of China's recent diplomacy is the dramatic improvement in the quality and effectiveness of its diplomatic corps. Chinese diplomats are better educated, more sophisticated, and able to operate more effectively in both bilateral and multilateral settings.³⁵ Aside from the issues of Taiwan and Japan, where nationalism and domestic political sensitivities inhibit flexibility, China's diplomacy is characterized by a willingness to listen closely to the desires and interests of its diplomatic partners and to formulate proposals for cooperation that respond to their needs while advancing Chinese interests. China uses diplomatic channels to employ or capitalize on the economic tools described above.

Several distinctive patterns are evident in China's diplomatic approaches:

Strategic Partnerships. China seeks to establish "strategic partnerships" with major countries and key regional organizations. To date, China has established partnerships with Brazil (1993), Russia (1996), France (1997), Saudi Arabia (1999), Iran (2000), ASEAN (2003), the European Union (2003), India (2003), the United Kingdom (2004), and Germany (2004).³⁶ A strategic partnership is a political declaration of mutual importance and goodwill; the content can vary from a quasi-alliance (some aspects of the Sino-Russian strategic partnership) to a vague political declaration (the partnership with India). China's partnerships with Russia, India, and the European Union, and its (failed) efforts to work toward a "constructive strategic partnership" with the United States, represent an implicit movement toward the multipolar world Chinese leaders would prefer. By supporting alternative power centers independent of the United States, China can increase its scope for diplomatic maneuver.

Beijing also employs the strategic partnership label as a tool for manipulating other countries. Actions that work against Chinese interests are criticized as evidence of hostility or behavior inconsistent with the strategic partnership. This theme figured prominently in Chinese efforts to persuade the European Union to lift its arms embargo. Beijing also pressures countries to demonstrate their commitment by increasing cooperation or making concessions. A strategic partnership also serves as a political umbrella for subsidiary agreements, for bilateral cooperation at lower levels, and for strategic dialogue between China and its diplomatic partners. China typically seeks to hold regular meetings with partners that serve as a venue for strategic discussions and provide opportunities to press China's current diplomatic agenda with foreign partners.

Leadership Travel and Meetings. China's top leaders travel extensively and regularly host visits with senior political figures from large and small countries. The Chinese system places high value on leadership meetings, both as symbols of political commitment and as means of obtaining substantive agreements. Major visits by Chinese leaders (and, to a lesser degree, visits to China by foreign leaders) also help coordinate foreign policy issues across ministerial boundaries.

Beijing emphasizes form and hospitality to ensure that foreign leaders have enjoyable visits (thus creating an implicit sense of obligation). This tactic is particularly effective with leaders of smaller countries, who are often flattered by the attention. China also pressures diplomatic partners to make concessions or enter into agreements to make high-level visits successful. For example, Philippine President Arroyo's September 2004 visit to Beijing was upgraded from an official visit to a state visit once the Philippines agreed to sign a joint agreement for seismic exploration in the South China Sea and to recognize China as a market economy.³⁷

Regional Organizations as "Influence Multipliers." China actively engages regional organizations such as the European Union, ASEAN, the Organization of American States, African Union, the

Anatomy of a State Visit

President Hu Jintao, accompanied by 200 Chinese businessmen, visited Brazil, Argentina, Chile, and Cuba from November 11–23, 2004, in conjunction with his attendance at the 12th Asia Pacific Economic Cooperation (APEC) leadership meeting in Santiago.

Before the Brazilian congress, Hu stated China would invest \$100 billion in Latin America over the next 10 years, with \$10 billion invested in Brazil in the next 3 years. Hu pledged \$20 billion in Argentina over the next 10 years to finance infrastructure, railway, aerospace, communications, and fossil fuel projects. While in Chile, Hu and Chilean President Ricardo Lagos agreed to begin talks on a free-trade agreement, and Chile was added to the list of approved Chinese tourist destinations. In Havana, 16 commercial agreements worth more than \$500 million were signed. Argentina, Brazil, and Chile all recognized China's market economy status during the trip; Peru, Venezuela, Suriname, and Guyana followed suit within months.

Preparations for Hu's trip began long before he touched ground in South America. Brazilian President Luiz Inacio Lula da Silva and Argentine President Nestor Kirchner both led major business delegations to China earlier in 2004. Da Silva attended the opening of the Beijing offices of the Brazilian state oil firm Petrobras, which signed a joint oil exploration accord with Sinopec later that month. Kirchner and Hu signed five cooperative agreements, with Argentina securing approved destination status for Chinese tourists. These high profile visits were supported by numerous lower-level visits by ministers, party leaders, and business representatives in the year before Hu's arrival. In 2004, Argentina and Chile both exchanged more than 60 delegations with China at or above the vice-ministerial level.

Shanghai Cooperation Organization (SCO), and the Gulf Cooperation Council. China conducts formal dialogues with some organizations; in others it has observer status. Attending meetings of regional organizations allows China to get its messages across to all members in one stop and to hold multiple bilateral meetings on the margins. China has provided many regional organizations with financial and technical assistance such as computers and telecommunications equipment.

China often uses its influence in regional organizations to advance its national objectives. For example, the July 2005 vote calling for SCO members to set a withdrawal date for U.S. forces using bases in Central Asia reflected Chinese and Russian concerns about a perceived U.S. role in the revolutions in Georgia, Ukraine, and Kyrgyzstan.³⁸ China also extended influence in the African Union to frustrate Japanese efforts to win endorsement of its bid for a permanent Security Council seat. The Japanese Ministry of Foreign Affairs had expected that Tokyo's development assistance to the region would produce support for Japan's Security Council bid.³⁹

China leverages its bilateral and regional multilateral diplomacy to reinforce each other. Bilateral influence is cultivated with weaker or poorer members of regional organizations; China then uses these members as sources of information on the organization's agenda and the positions of key members. It then seeks to persuade them to advance Chinese positions or proposals within the multilateral setting. Conversely, if most members of a regional organization support a Chinese initiative, pressure is produced against reluctant countries not to frustrate consensus.

China has worked the bilateral/regional dynamic most effectively with Asia, where it has become a major player in regional diplomacy. Interviews with officials in key ASEAN countries indicate that Chinese bilateral influence in Thailand, Cambodia, Laos, and Myanmar (Burma) gives it significant influence over ASEAN's agenda.⁴⁰ Because ASEAN is a consensus-based organization, China can use its relationships to block unwanted initiatives or actions by the group. China

has also leveraged its relationship with ASEAN to garner support for the ASEAN + 3 process and build momentum for regional economic integration. Chinese trade liberalization initiatives have placed Tokyo in a reactive posture, since Japanese internal politics limit Tokyo's flexibility.

China has used multilateral diplomacy effectively outside Asia. For example, Chinese President Hu coupled participation in the November 2004 APEC Summit in Santiago with high-profile bilateral visits to Argentina, Brazil, and Chile. He used the trip to tout significant Chinese investments in the region and to begin negotiations on a bilateral free trade agreement with Chile.

Within Asia, Beijing clearly prefers multilateral organizations that exclude the United States, allowing China to exert more influence. China has taken the initiative in this area rather than reacting to strategic developments. Beijing has backed the creation of new organizations and initiatives such as the SCO, ASEAN + 3, and the East Asian Summit but has been less enthusiastic about the APEC forum and the ASEAN Regional Forum, both of which include the United States. Beijing prefers to address regional trade liberalization in the ASEAN+3 setting rather than APEC.

China's recent Asian diplomacy illustrates this tendency. Foreign Minister Li Zhaoxing attended the first day of the July 2005 meeting of the ASEAN Regional Forum, and then skipped the rest for an extended bilateral visit to Myanmar. Beijing's enthusiasm for the East Asian Summit in December 2005 cooled remarkably following the expansion of the group to include India, Australia, and New Zealand. China likely supported the requirement that summit participants accede to ASEAN's Treaty of Amity and Cooperation as a means of excluding the United States.

The preference for organizations that exclude the United States extends to the nongovernmental level, where Beijing established the Network of East Asian Think-Tanks in 2002 to support research and nongovernmental formulation of proposals for increased regional cooperation on issues such as economic integration and energy security. Wu Jianmin, president of the China Foreign Affairs University (under the Foreign Ministry), serves as the "General Coordinator" of the network.⁴¹

Exercising Influence on Behalf of Others. China sometimes uses its influence in multilateral organizations on behalf of friendly states to advance its regional interests indirectly. As a member of the Security Council and a key player in other international organizations, China can block or delay these organizations from taking action. Often this influence is used on behalf of pariah states or to relieve pressure on governments friendly to China to comply with international norms.

Beijing's efforts to prevent or delay referral of Iran's noncompliance with its nuclear safeguards agreement from the International Atomic Energy Agency (IAEA) to the UN Security Council illustrate this tool. Chinese Foreign Minister Li Zhaoxing traveled to Tehran in early November 2004 to meet with Iranian President Mohammad Khatami to discuss the issue; Iran's representative to the IAEA subsequently visited Beijing for consultations on the eve of a critical IAEA board meeting.⁴² China has continued to work closely with Russia to limit Security Council action on the issue. Beijing's primary motive is securing long-term access to Iranian oil and natural gas for Chinese national oil companies.⁴³ China has also frustrated Security Council action against the Sudan government for human rights violations in Darfur. China National Petroleum Corporation has extensive oil investments in Sudan, which supplies half of Chinese overseas oil production.⁴⁴

Defense Cooperation

China employs a range of security assistance tools to advance its foreign policy interests. Arms sales and exports of technology for weapons of mass destruction (WMD) and ballistic missiles were important sources of Chinese influence in the 1980s through the mid-1990s, but have declined in importance as Chinese arms have become less competitive in the marketplace and as China has

taken on increasingly specific nonproliferation commitments. China now places greater emphasis on military diplomacy and capacity building programs, and is starting to become a significant exporter of conventional military technology.

China's global arms exports have declined dramatically from the peak years in the mid-1980s, when Chinese firms were supplying both sides in the Iran-Iraq war. In 1987, China's arms sales hit a high point of \$5.8 billion.⁴⁵ In contrast, Chinese arms sales totaled \$300 million in 2003 and \$600 million in 2004.⁴⁶ Because China's defense industries still cannot produce state-of-the-art weapon systems, Chinese arms compete on the basis of price rather than capabilities. Customers tend to be cash-strapped developing countries in South Asia, Latin America, Africa, and the Middle East that are willing to trade advanced capabilities for lower cost. Willingness to finance purchases or to provide arms at "friendship prices" is often an important selling point. Some countries, such as Kuwait and Thailand, have purchased Chinese arms as a symbol of political cooperation.⁴⁷ Continuing improvements in China's defense industry may improve the future quality of its arms and the relative importance of arms sales as a foreign policy tool.⁴⁸

Increasing Emphasis on Military Diplomacy. China has stepped up its military diplomacy activities dramatically since late 2001. Annual defense consultations with Thailand, Pakistan, the United Kingdom, Germany, South Africa, and Mongolia have been established to complement existing relationships with France, Russia, Japan, and the United States. According to the 2004 Defense White Paper, China has established military relations with more than 150 countries in the world and set up over 100 military attaché offices. In 2003 and 2004, the PLA sent high-level military delegations to over 60 countries and hosted more than 130 delegations of military leaders from over 70 countries.⁴⁹ One new pattern is that military region commanders, political commissars, and staff officers below the four military departments conducted much of the travel to Africa and Latin America, while senior PLA officers focused on larger countries and relations with major powers. (This partly reflects PLA regulations that limit flag officers to one overseas trip per year.) China has conducted maritime search and rescue exercises with India, France, the United Kingdom, and Australia, and held counterterrorism exercises with Pakistan and the SCO.⁵⁰

Security Assistance and Training. Security assistance efforts are concentrated on smaller developing countries where a limited investment of resources can produce substantial political dividends. Latin America, Africa, Southeast Asia, and Central Asia are the central arenas for these activities.

China often provides relatively small grants to purchase uniforms or military equipment for foreign militaries, police, and internal security forces in African, Latin American, and South Asian countries. Typical examples include uniforms for the armies of Afghanistan and Tajikistan, 20 jeeps for Kyrgyzstan's Ministry of Public Security, and 40 all-terrain vehicles for the Kazakhstan military. Underfunded militaries and security services welcome these small amounts of assistance. China has also used the SCO framework to provide counterterrorism training and border security assistance for Central Asian countries, including funding for radiation detection equipment at border crossings.

China has used its relationship with ASEAN to propose security cooperation in the ASEAN+China and ASEAN + 3 settings. China and ASEAN signed a joint declaration on cooperation on nontraditional security measures in November 2002.⁵¹ China likely views cooperation on these issues as less sensitive and therefore more acceptable to ASEAN countries concerned about protecting their sovereignty.

Exports of Military Technology. Beijing has used military technology transfers and transfers of missile and WMD technology as political tools in the past, notably in its transfer of nuclear weapons design information and missile technology to Pakistan and its assistance to Iranian missile programs.

China's gradual acceptance of nonproliferation norms, membership in key nonproliferation regimes, and efforts to build an effective export control system have significantly reduced Chinese proliferation activity, both in terms of the sensitivity of the items transferred and the number of countries involved. However, China continues to supply some missile technology to Pakistan, Iran, and likely other countries as a means of advancing its strategic interests.⁵² Much of this activity involves exports of dual-use technologies with legitimate commercial applications that can also be used in WMD and missile programs.

Chinese exports of defense production technology may be increasing. China has longstanding defense technology ties with Pakistan that include transfers of production technology for tanks and aircraft. In 2004, China offered to supply arms and technology for arms production to the Philippines, Malaysia, and Indonesia.⁵³ Beijing subsequently signed defense cooperation agreements with Indonesia (July 2005) and Malaysia (September 2005). The Indonesian agreement reportedly includes Chinese assistance in helping Jakarta develop and produce antiship missiles.⁵⁴

China's security relationship with Russia has expanded in recent years to include Chinese funding for joint military technology development projects. Chinese arms purchases and support for military research and development activities play a critical role in sustaining Russia's defense science and technology infrastructure. This provides Beijing a source of influence and facilitates access to advanced Russian military technology through overt and covert means. Russian officials and defense firms have also expressed interest in collaboration with China to produce advanced fighter aircraft.⁵⁵

Soft Power

China has carved out a new identity as a successful "authoritarian development state." Some believe the approach of reforming the economy while limiting political freedom represents a new model with considerable appeal to authoritarian leaders in developing countries.⁵⁶ China's manned space flights are cited as evidence of scientific and technological success that creates soft power. China's development model actually draws heavily on orthodox development economics and benefits from special factors such as a large domestic market and large labor supply that cannot readily be replicated by most other countries.⁵⁷ Domestic problems, social inequality, environmental degradation, and periodic political clampdowns also limit China's attractiveness as a model for others to emulate. A slowdown in growth or a major political incident would highlight these issues and significantly reduce China's ability to employ soft power as a diplomatic tool.

The Chinese government is devoting significant resources to promoting Chinese culture and language as a means of increasing its soft power. Foreign student enrollment in Chinese universities has increased from 85,000 in 2002 to 110,000 in 2004. About 75 percent of foreign students are from Asian countries, with South Korea (43,600) and Japan (19,000) sending the most students in 2004. Much of this increase is due to the commercial orientation of Chinese universities, which profit from foreign student enrollments and have developed programs to serve this market. However, the Chinese government provides scholarships and financial assistance for students from developing countries. This funding likely accounts for significant increases in the number of students from Africa and South Asia.⁵⁸

Appeals to cultural and linguistic affinities are especially important in dealing with countries with considerable ethnic Chinese minorities. Malaysia and Indonesia, which previously viewed their ethnic Chinese populations with suspicion, now regard them as an asset and comparative advantage in building economic relations with China. China found some sympathy in Southeast Asia for appeals to

“Asian values” during its efforts to resist human rights pressure from the United States and Europe in the 1990s. However cultural and linguistic diversity in Asia is likely to limit China’s ability to harness purported common “Confucian values” as a diplomatic tool.

Military Power

The PRC possesses significant military capabilities, which it has historically been willing to use in pursuit of its national interests.⁵⁹ The immediate focus of Beijing’s military buildup is on deter-

ring Taiwan independence and creating the conditions necessary for unification on PRC terms. However, China is gradually expanding its power projection capability within Asia, which will increase its regional influence.

Military power is an important element of national power, but it can also have unwanted side effects. China’s growing defense spending and expanding military capabilities are sparking concerns within Asia. These are most evident in Japan, which increasingly views China as a regional rival and potential military threat. Beijing’s efforts to reassure its Asian neighbors that it does not pose a security threat are complicated by its expanding military power.

China’s limited power-projection capabilities reduce the risk that its military power will interfere with efforts to expand Chinese influence in more distant regions. China’s response to the Indian Ocean tsunami revealed limitations on its ability to provide military assistance in an emergency or a military conflict. China does provide increasing numbers of military and police forces to several UN peacekeeping operations. As of December 2004, more than 1,000 Chinese military and police personnel were deployed on 11 different operations in Africa, Asia, Latin America, and Europe.⁶⁰ China’s contributions to UN peacekeeping missions usually consist of engineering or support troops rather than combat units.

Language and Soft Power

China’s growing interest in expanding its “soft power” is highlighted by efforts to promote the Chinese language. The National Office for Teaching Chinese as a Foreign Language has earmarked \$200 million annually to establish a global network of Confucius Institutes to promote the study of the Chinese language. The aim is to “enhance the mutual understanding and friendship between the Chinese people and other peoples of the world, promote economic and trade cooperation as well as scientific, technological and cultural exchanges between them.”

The first of 27 Confucius Institutes was established in Seoul in November 2004, with plans for approximately 100 within 5 years. Locations are scattered around the globe from Pakistan and Uzbekistan to Canada and Japan. The first American Confucius center was recently established at the University of Maryland.

The National Office provides general guidance and priorities, but Confucius Institutes are administered autonomously. Political activities are specifically prohibited. However, Confucius Institutes may further marginalize Taiwan by promoting the use of simplified Chinese used in the mainland rather than the traditional characters used in Taiwan.

Data on Chinese Regional Priorities

Lack of direct knowledge about internal Chinese strategic deliberations necessitates examination of China’s observed behavior and inferences about its underlying priorities and strategy. One starting

point is to analyze the factors driving China’s increased global activity and how China is employing available foreign policy tools. Two additional approaches can help illuminate Chinese priorities and strategies. One approach is to compare PRC official statements to different domestic and international audiences with observed behavior. What do discrepancies in statements to different audiences and divergences between stated objectives and observed behavior suggest about Chinese objectives and strategies?

Chinese leaders obviously adapt their remarks to particular audiences, but some points stand out clearly from a brief review of themes in Chinese speeches and statements:

- Chinese public statements consistently emphasize the “win-win” and mutually beneficial nature of economic cooperation with other countries and highlight common interests in

resource commitment. This is reinforced by the extensive preparations and diplomatic advance work that accompany leadership travel in order to maximize the returns. The figures below show the foreign travel by China's President and Prime Minister and foreign minister in 1993, 1998, 2002, 2003, and 2004.

Several patterns stand out in this data:

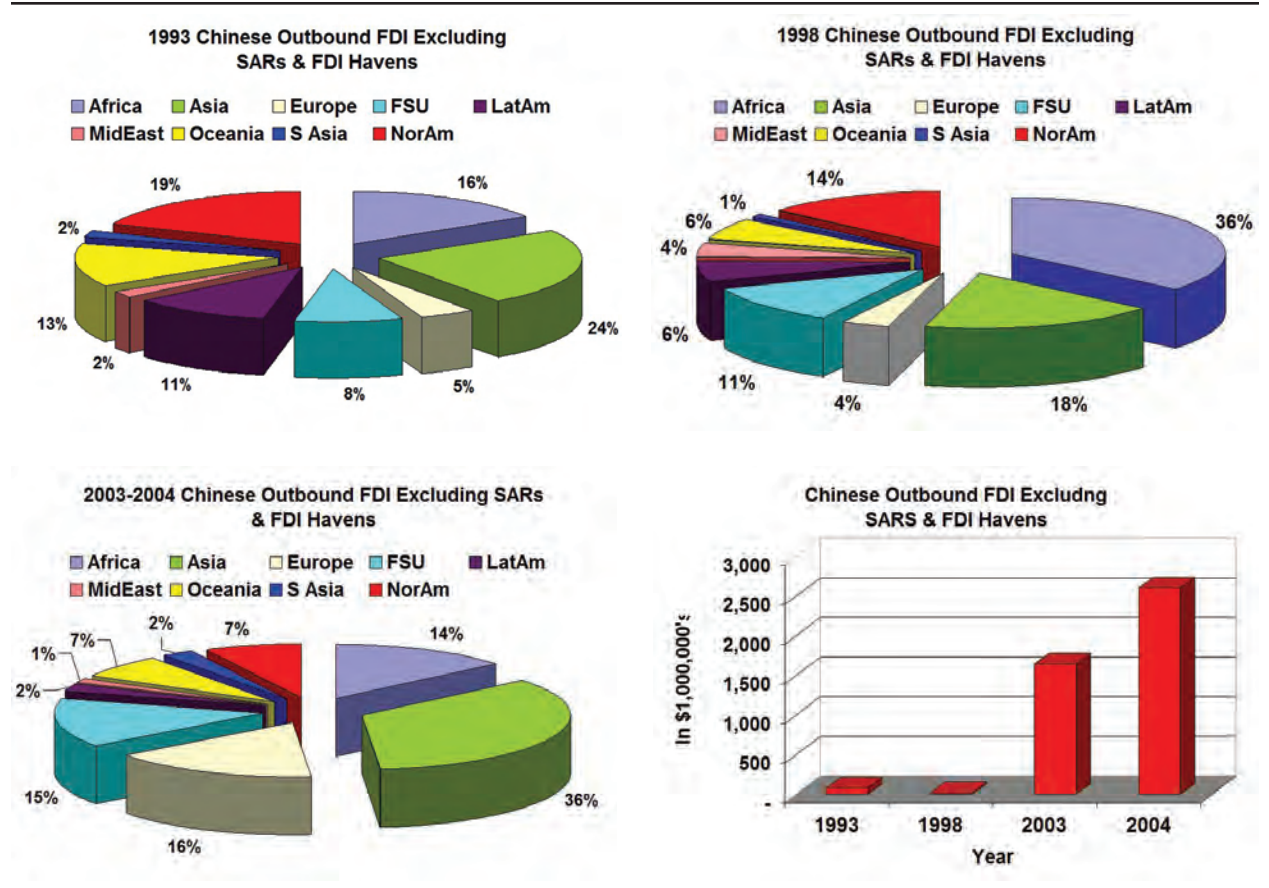
- The total number of days spent abroad by top leaders in 2002–2004 increased significantly. The 2003 data was down slightly due to the Party Congress and the leadership transition from Jiang Zemin to Hu Jintao; 1993 data was artificially low because Premier Li Peng suffered a heart attack and did not travel.
- Travel was focused on Europe and increasingly on Russia and the former Soviet Union (especially Central Asia). This correlates with Chinese efforts to establish a strategic partnership with the European Union and increased interactions with Central Asian countries that are members of the Shanghai Cooperation Organization.
- The president, premier, and foreign minister traveled extensively in Africa and Latin America in 2002–2004. As a matter of policy, the Chinese foreign minister's first trip every year is to Africa.
- Leadership visits emphasized countries with energy or other natural resources in 2002–2004. Fifty-two percent of the countries visited by top leaders were oil and/or natural gas producers; 64 percent exported energy or another significant natural resource. If travel to the United States and Europe is excluded, the percentages are even higher (65 percent and 72 percent, respectively).

Hosting Foreign Leaders. Hosting visits by senior political figures from other countries involves a commitment of state resources, but imposes fewer demands on the time of top Chinese leaders since they do not need to travel and typically meet with visiting leaders only for a short private meeting and a ceremonial meal. Visits by foreign political leaders to China increased significantly in the 2002–2004 period compared with 1993, with the increase in visits by European presidents and prime ministers especially notable. Contacts between Chinese cabinet ministers and their counterparts in Europe and Asia have also increased significantly.

Outbound Foreign Direct Investment. Official Chinese data on outbound FDI captures investments that go through a formal government approval process. This data misses a significant amount of FDI financed by retained foreign earnings of Chinese enterprises and by funds raised via foreign capital markets. The Chinese government may also have other mechanisms for approving investments that bypass the established process. The figures below exclude FDI to Hong Kong and Macao (which account for the bulk of Chinese FDI) or routed through Bermuda, the Cayman Islands, and the Virgin Islands to unknown destinations. Despite these shortcomings, the official data give some indication of Chinese priorities.

Detailed 2005 data broken out by country is not yet available. However, press reports indicate total outbound FDI was \$6.92 billion. About \$4.07 billion was new capital investment from China, with the rest derived from retained overseas earnings of Chinese companies.⁶² A significant portion of this investment was used to acquire foreign companies.⁶³ FDI in the mining/energy sector increased from \$1.38 billion (48.4 percent) in 2003 to \$1.9 billion (53 percent) in 2004 before falling to \$1.17 billion in 2005.⁶⁴ Outbound investment in the first quarter of 2006 totaled \$2.68 billion, suggesting that Chinese outbound FDI is accelerating.⁶⁵

Available data reveal a significant increase in outbound Chinese FDI, but the total amounts captured in the official data fall far short of the numerous multi-billion-dollar investments mentioned in press reports. For example, Hu Jintao pledged during his 2004 trip that China would invest \$100 billion in FDI into Latin America over the next decade, including \$20 billion in Argentina. The official FDI data cited above does not appear to include large (often multi-billion-dollar) oil and gas investments by Chinese national oil companies in Iran, Angola, Ecuador, and Sudan. These investments may be funded using resources the companies acquire from international capital markets or by loans from Chinese banks that are not included in the official FDI data.⁶⁶



Chinese Development Assistance. The limited official data available are insufficient to accurately determine the total volume of Chinese grant and loan aid or the precise breakout in terms of recipients. Open source data describe many projects that receive Chinese assistance and sometimes report aggregate totals for Chinese bilateral assistance. However, press reports typically lack details on the nature and form of Chinese assistance, report total project costs without specifying the percentage of Chinese support, and confuse commercial investments with foreign assistance. Reports often incorporate previous and prospective assistance to arrive at exaggerated totals.

Despite these caveats, some important details emerge from an analysis of open source reports on Chinese development assistance:

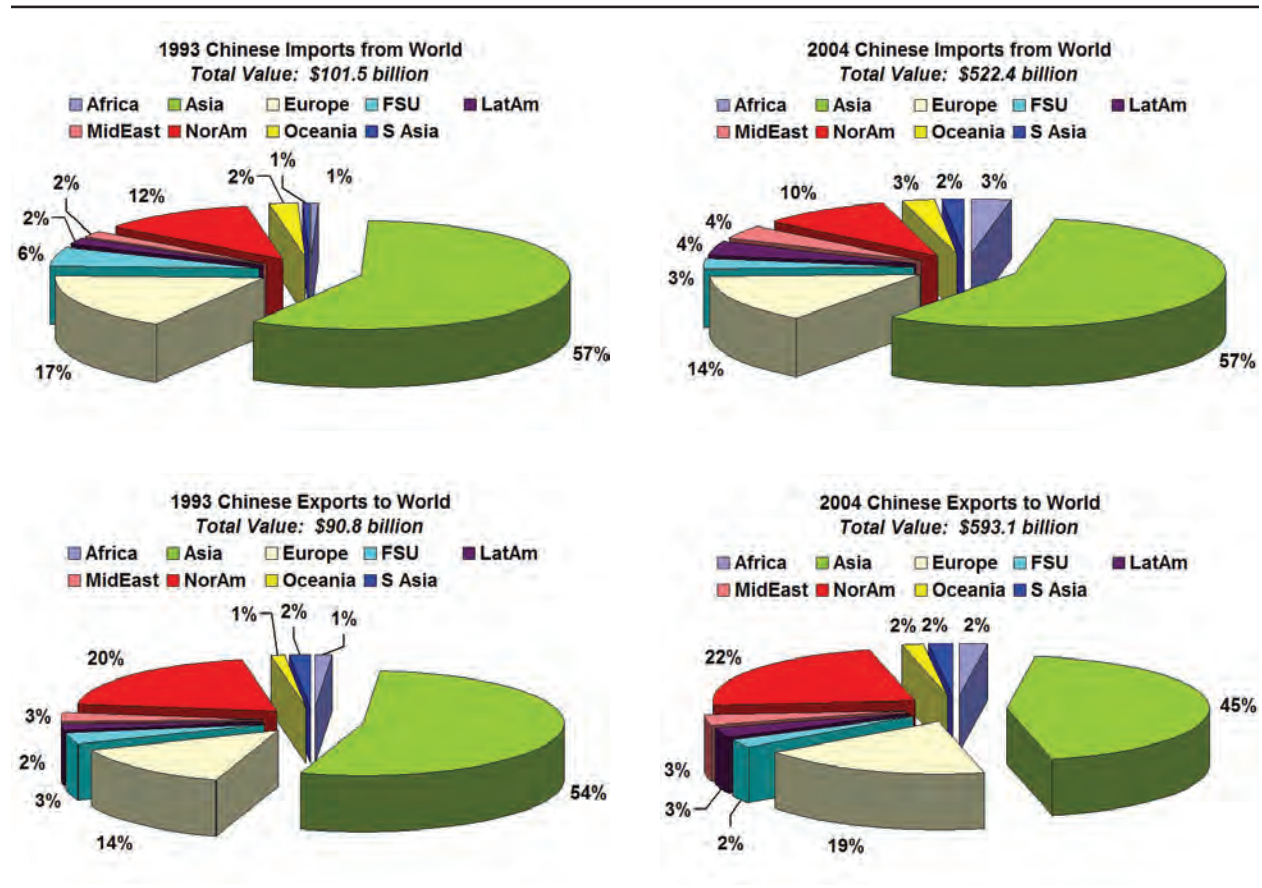
- China provided more than \$5 billion in assistance to Indonesia and Thailand in 1998 during the Asian financial crisis.
- Chinese assistance to Pakistan increased dramatically in 2003–2004, with press reports citing more than \$6.8 billion in assistance for projects such as a nuclear reactor, power plants,

railroad improvements, and general development assistance. This assistance follows a major Chinese project to expand the Pakistani port of Gwador and is likely intended to help stabilize Pakistan politically (or to build a presence that will ensure good ties with any successor regime).

- Chinese development assistance in Africa includes numerous large grants and loans to oil-producing states such as Angola, Sudan, and Nigeria. Some grants fund infrastructure projects such as railroads, power plants, and power lines. Others involve debt relief or provide financing for the purchase of Chinese goods.
- Open source analysis suggests a crude estimate of total Chinese grant and loan development assistance in 2004 is approximately \$10 billion. Iran, Pakistan, and North Korea appear to be the largest beneficiaries. The total amount of development assistance announced appears to have increased significantly in the last 2 years.

Chinese Trade Patterns. Trade is not a direct indicator of government resource commitments, but the role of exports in the Chinese economy makes expanding markets critical to maintaining rapid economic growth. Chinese leaders seek to use commercial diplomacy to advance market access for firms. Imports are also significant, both for meeting the resource requirements of China's booming economy and as a potential tool of political influence.

Trade benefits countries by allowing efficiency gains from specialization in areas of comparative advantage and increased consumption choices. Both imports and exports can increase a country's overall welfare. As a general rule, however, sudden import surges tend to generate political friction in bilateral relations, since many countries seek to maintain a trade surplus and view imports as competition



for domestically produced goods. Conversely, most leaders view exports as contributing to economic growth and supporting domestic employment. Dependence on access to a country's export market can therefore be an important source of political influence, especially if a smaller country's economy is dependent on a larger country.⁶⁷

The figures use Chinese customs data to highlight changes in China's imports and exports to different regions from 1993 to 2004. Trade re-exported to other countries through Hong Kong is included in the totals for the Asia region.

Several important patterns stand out in China's trade relations. First, other East Asian countries are becoming more dependent on exports to China, but China's relative dependence on East Asian markets is staying the same (see table 1). This reflects both the shift of export production from other East Asian economies to tap Chinese labor and the Chinese domestic market's appetite for imports from Asia. If the China-ASEAN Free Trade Agreement is implemented, ASEAN dependence on the China market will increase even more.

Table 1. Dependence on Imports from and Exports to China (% of Total Imports/Exports)

	1993	1998	2002	2004	1993	1998	2002	2004
	Imports	Imports	Imports	Imports	Exports	Exports	Exports	Exports
<i>East Asia</i>	6.24	9.62	13.17	15.89	6.64	6.99	12.35	16.32
Japan	6.53	10.56	14.37	16.16	6.42	7.29	12.83	16.68
South Korea	3.30	6.70	10.21	11.89	6.25	11.31	17.69	25.19
Taiwan	1.91	3.70	5.85	8.07	15.20	15.04	29.15	37.2
ASEAN	2.29	4.02	6.64	8.43	2.94	3.83	7.71	11.03
<i>South Asia</i>	3.54	3.83	5.79	7.59	1.57	2.59	4.03	7.53

Second, China's economy remains heavily dependent on exports to the United States, Japan, and Europe. China runs large trade surpluses with the United States (\$114.2 billion in 2005) and Europe (\$35.4 billion in 2004). These figures are PRC customs data that do not capture all exports that pass through Hong Kong, and therefore understate China's total dependence on these markets. (U.S. Customs data shows a PRC trade surplus of \$201.6 billion in 2005.) China's dependence on these exports likely raises concerns for Chinese leaders that increasing protectionist sentiment may slow future export growth to these markets. Japan has lowered trade barriers to Chinese exports, partly because many of the goods Japan imports are produced in factories owned by Japanese multinational corporations.

Third, China runs a trade deficit with the Middle East due to imports of oil and natural gas (\$2.3 billion in 2004). This deficit will rise as Chinese energy imports from Middle Eastern countries increase in coming decades. Beijing hopes to increase exports of consumer and industrial goods and of labor and construction services to the Middle East to offset this trade deficit.

Fourth, trade with the Middle East, Africa, Latin America, and Australia is increasing as a percentage of China's total trade. Imports from these regions are growing rapidly as Chinese demand for energy, natural resources, and commodities surges. Chinese exports to these regions, especially to Latin America, are also increasing rapidly (see table 2).

Table 2. Chinese Export and Import Growth (%)

	2003 Imports	2003 Exports	2004 Imports	2004 Exports
Middle East	53.2	43.6	48.6	28.3
Africa	54.0	13.6	87.2	35.6
Latin America	78.7	24.3	45.9	55.0
Australia	24.8	36.6	58.3	41.1
World	38.4	33.8	34.8	35.4

Is China's Increased Global Activism the Product of a Global Strategy?

Do the pattern of increased Chinese activity and the resource commitments described above reflect a common strategy that is being applied across different regions? Almost all the Chinese activities discussed in this report are consistent with a grand strategy of maintaining a peaceful international environment that allows China to build the economic and technological foundations necessary to become a rich and powerful country. These principles can be understood as the basis of a relatively coherent grand strategy. However, they are too vague to provide specific guidance about how China should deal with great powers, allocate resources across different regions, and manage the domestic and international challenges of achieving rapid development in a globalized world economy.

In practice, Chinese foreign policy reflects efforts to balance strategic and economic considerations and to coordinate the activities of diverse Chinese economic and political actors to advance national goals. Foreign policy is subordinate to domestic concerns, especially given the perceived imperative for rapid economic growth to maintain communist party rule. Efforts to formulate a coherent policy are impeded by bureaucratic and political conflicts of interest, while policy implementation is often impeded by incentives of Chinese actors to evade government directives that conflict with their underlying economic and political interests.

Balancing Strategic and Economic Considerations

Chinese foreign policy is best understood as the outcome of the interaction between two independent sets of policies, one focused on strategic concerns and the other on meeting economic development needs (which are critical for domestic stability and regime survival).

The *strategic track* is driven by international threats and opportunities and by China's changing role in the global balance of power (with leadership fears of possible U.S. actions to contain or subvert China a critical factor). This logic explains Chinese efforts to build or strengthen strategic partnerships with Russia, key European countries, and emerging powers such as India. China seeks to prevent their participation in any potential future U.S. effort to contain China and to encourage them to play a more independent international role to balance U.S. power. It also explains China's efforts to strengthen ties in East Asia and Central Asia (since 1996) and to promote Asian regional organizations that exclude the United States (since 2001). China's actions reflect a desire to deny Washington regional support for any potential future efforts to contain China or to intervene in a Taiwan conflict. Stronger relations with Asian countries (and U.S. allies in particular) also support PRC efforts to gradually reduce U.S. influence in the region.

The *economic track* is driven primarily by development needs and by China's changing role in the world economy. China's increasing demand for economic inputs and for access to export markets follows a logic and geography independent of strategic concerns. For example, China has become more dependent on exports to developed countries to maintain economic growth—including on countries such as the United States and Japan, which its leaders regard as potential threats.

The dramatic increase in Chinese activity in the Middle East, Africa, Latin America, and (to a lesser degree) Central Asia since 2001 reflects both resource acquisition and efforts to build export markets in developing countries. Chinese companies are also being pushed to expand overseas by domestic competition. Many countries in these regions share China's interest in resisting U.S. efforts to promote democracy and to intervene in other countries.

Strategic and economic concerns are intertwined in Chinese efforts to secure access to oil, natural gas, and other resources necessary for economic development. Chinese leaders see intensifying international competition to secure long-term access to energy and other resources and believe the state must play a major role in helping national companies. The Chinese government is using diplomatic efforts to support companies and is likely providing significant financial support through the banking system. (Lack of information about the balance sheets of Chinese policy banks and the operations of China's state-owned oil and resource companies preclude an estimate of the amount of state resources devoted to this effort. Fragmentary evidence suggests the amount may be in the tens of billions of dollars, although this likely includes agreements that have not been implemented yet.) Government pressure and commercial considerations have prompted state-owned firms to make aggressive efforts to purchase resources and establish long-term supply contracts. This has led to increased activity focused on countries with available stocks of resources, including investments in states with questionable regimes such as Iran, Sudan, Angola, and Myanmar. It may also have led Chinese firms to pay inflated prices for access to some resources.

The strategic and economic rationales for China's increasing global activism reinforce each other in some places (especially in Asia, Latin America, Africa, and the Middle East) and conflict in other places (especially in relations with the United States and Japan). When strategic and economic interests have come into conflict, Chinese leaders have usually compromised on strategic issues in order to allow economic growth to continue. Beijing's efforts to accommodate Washington since fall 2000 are the most important example, but relations with Tokyo also broadly fit this pattern.

Taiwan's importance to regime legitimacy and role in internal leadership competition make this issue a potential exception. However, China has focused its diplomacy on the near-term objective of preventing Taiwan independence and hopes that long-term trends will help it achieve its stated objective of peaceful reunification without a conflict with the United States that would derail China's economic development.⁶⁸

Implementation Challenges and Conflicting Interests

Much of this report has focused on Chinese national interests as viewed by top leaders, including emphasis on the conflicts between strategic and economic considerations. This conceptual approach provides important insights into Chinese strategic thinking and policy choices. However, analysis of national interests must be supplemented by an awareness of the bureaucratic and domestic political forces that influence policymaking and by an understanding of how the conflicting interests of Chinese government and commercial actors affect (and often impede) efforts to implement a coherent national policy.

Coordination Mechanisms. The Chinese government seeks to use campaigns (such as the “go global” investment campaign), economic and political incentives, and mechanisms such as leadership travel to coordinate government and firm efforts and to resolve conflicts of interest.

These efforts sometimes produce impressive tactical successes, such as Hu Jintao’s 2004 trip to Latin America. The involvement of a senior Chinese official forced the relevant ministries to coordinate their individual efforts to produce the concrete diplomatic and economic agreements necessary to make Hu’s trip a success. Hu’s potential ability to open doors with foreign governments attracted numerous Chinese company leaders (who also valued the chance to advance their business interests with senior Chinese officials).

According to Western consultants, Chinese officials have sometimes forced Chinese companies to undertake construction projects in Africa at a loss in order to advance broader interests. However, conflicts of interest and personal incentives often lead ministries, companies, and local government leaders to pursue their own interests rather than central government goals.

Bureaucratic Interests, Domestic Politics, and the Policy Process. The Chinese policy process reflects diverse bureaucratic and political interests and typically produces incremental policy changes that reflect compromises between competing actors and interests. Sustained attention by senior leaders can sometimes overcome this tendency, but only on a limited number of issues where top leaders are actively and consistently engaged.

Chinese policy on energy security illustrates the limits that competing bureaucratic interests and domestic political considerations can place on policy coherence. Chinese leaders clearly recognize the importance of energy security and have demanded active efforts by government ministries and Chinese national oil companies to secure energy supplies needed to support future growth. Energy security was the subject of a Politburo study session in June 2005; press reports claim that Hu Jintao has demanded that Chinese energy companies become more active in efforts to secure supplies.⁶⁹

However, energy security is an inherently difficult objective that requires coordinating domestic investments in energy production and transmission; domestic price and tax incentives to ensure adequate distribution and efficient use of scarce energy resources; foreign policy efforts to provide diplomatic support for access to overseas energy sources; financial efforts to provide resources to Chinese state-owned energy companies; and technological and infrastructure investments to build the capability to extract and transport energy to China in a useable form.

A rational energy policy requires making optimal trade-offs between short- and long-term supply issues, between investments in alternative sources of energy, between security of supply and the lowest price, and between national sources of supply and energy purchased on international markets. Making optimal choices (and adapting them as energy market conditions change) is a huge challenge for China’s decisionmaking system, which relies heavily on bureaucratic compromise.⁷⁰

China has sought to address energy security by establishing a new energy leading group headed by Premier Wen Jiabao to make policy decisions on energy security. Implementation will be handled by the Energy Bureau, a subministerial body under the State Development and Reform Commission.⁷¹ However, Western energy experts doubt that these bodies have sufficient bureaucratic stature to craft and implement a coherent policy for energy security. They also note that the policymaking offices are understaffed and have routinely approached Chinese national oil companies for policy suggestions (when the offices are supposed to be developing national policy to regulate the activities of Chinese oil companies).

Concerns about the impact of rising energy prices on domestic output and employment prompted the Chinese government to allow the gap between subsidized domestic oil and gasoline prices and world prices to increase significantly in 2004–2005. As a result, Chinese producers and

consumers were paying artificially low prices for energy (and therefore consuming too much), while Chinese refiners and energy producers had economic incentives to export gasoline rather than selling it to domestic consumers at a loss. These conditions produced scattered oil and gasoline shortages that forced a number of Guangdong factories to shut down production in summer 2005. The Chinese government eventually responded by raising domestic prices.

Conflicting Incentives and Policy Implementation. Chinese foreign economic policies are implemented by a diverse group of actors that includes government ministries, provincial and local government officials, state-owned enterprises responsive to both profit incentives and government edicts, and even to some extent the foreign-invested enterprises that account for about 60 percent of Chinese exports.

Chinese leaders seek to employ commercial diplomacy, incentives, and administrative guidance to encourage Chinese enterprises to pursue state goals such as increasing export growth or acquiring resources. Yet these policy tools often run at cross purposes with the economic interests of individual firms and the political incentives of local government officials.

Chinese firms are increasingly focused on profitability. While managers take advantage of subsidies and other forms of state assistance, firms face increasing domestic and international competition that limits their ability to engage in unprofitable activities. Many Chinese firms are pursuing foreign investment as a survival strategy due to declining profit margins and increased competition in domestic markets.

Firms routinely evade environmental and labor regulations likely to interfere with profitability. Sometimes this involves the use of bribes to persuade government officials to look the other way; in other cases, mutual interest in promoting local economic growth is sufficient. Illegal coal mines, which violate environmental laws and often have unsafe working conditions, became a major issue following a series of deadly accidents in summer 2005.

The Chinese government has been unable to impose a geographical or functional division of labor on the three major national oil companies (China National Petrochemical Corporation, China National Petroleum Company, and China National Offshore Oil Company). All three companies have subsidiaries that are listed on international stock markets and have independent representatives on their boards. Chinese national oil companies pursue independent strategies to try to secure access to oil and natural gas fields, which sometimes results in two Chinese companies bidding against each other for the same development opportunity.

Meeting or exceeding economic growth targets is a key criterion for promotion of local government officials to higher positions. This gives local leaders strong incentives to evade central government policies that impede growth and to make concessions to attract foreign investment. Government policies that have delegated decisions on approving incoming and outbound foreign investment down to provincial and city governments further reduce Beijing's ability to implement a national policy.

Outlook and Implications

China has significantly increased its commitment of resources to improving relations with key countries and regions since 2001. Leadership travel, outbound FDI, development assistance, and trade ties have all increased dramatically, especially in 2004 and 2005. Over the next 5 years, significant additional increases in resource commitments and in China's level of global activism are likely.

China's FDI and development assistance efforts are relatively modest compared with U.S., European Union, and Japanese programs. However, China uses these tools effectively and strategically to advance specific interests. The pattern of China's actual resource allocation reflects both strategic interests (in relations with great powers and Asian countries) and economic interests (in securing resources and expanding markets in Asia, Latin America, Africa, and the Middle East). China's recent commitments to increase FDI and development assistance to Africa, Latin America, and the Middle East are much larger than historical levels. China probably significantly increased resources allocated to these activities in its 2006 5-year program, but is still unlikely to be able to fulfill all of its pledged commitments.

China has expanded its influence in Asia, Latin America, Africa, and (to a lesser degree) the Middle East. Beijing has taken advantage of opportunities created by the U.S. Government focus on terrorism, the unpopularity of some U.S. policies and actions (especially in the Muslim world), and relative U.S. neglect of Latin America, Africa, and Southeast Asia. China's limited allocation of resources can yield significant influence, especially in areas where U.S. and Western activities and attention are limited.⁷²

One countervailing factor is an emerging backlash as Chinese goods displace local products from domestic and traditional export markets and as the Chinese commercial and labor presence produces political frictions with local workers and businesses. If heightened expectations of Chinese investment and development assistance are not fulfilled, anti-Chinese sentiment is likely to intensify. For example, Mexico and Brazil have expressed reservations about the economic impact of competition with China; Southeast Asian nations worry that China's attractiveness as a site for international FDI is diverting investment and damaging their economic development prospects.

After a decade of relatively balanced global trade, China is beginning to run significant trade surpluses. In 2005, China enjoyed a \$102 billion trade surplus. If goods re-exported through Hong Kong are included, the total Chinese trade surplus was likely even higher (perhaps \$125 billion).⁷³ China's currency peg to the dollar has resulted in a weaker *renminbi* as the U.S. dollar has declined in value. European and Asian exporters (and U.S. manufacturers) complain that this gives Chinese goods an unfair advantage in international markets. China's shift to a managed float exchange regime in July 2005 has produced a slight increase in the value of the *yuan* against the dollar, but not enough to address complaints that the Chinese government is manipulating the value of its currency to gain a trade advantage. These macro-economic factors are likely to become a growing source of friction in China's bilateral relations.

All things being equal, the increased Chinese resource commitments on the horizon are likely to translate into significant increases in Chinese global and regional influence over the next 5 years. However, China's ability to deliver on its promises depends heavily on the government's ability to maintain domestic stability and to continue rapid economic growth.

Implications for the United States

China's increased global activism and influence poses a variety of diplomatic, economic, and security concerns for the United States. Not all of the implications are negative. Many aspects of China's expanding activities are a necessary byproduct of its rapid economic growth and integration into the world economy. China's growth produces some significant benefits and opportunities for the United States, especially when contrasted against the alternative of a failing China.

Diplomatic Implications. China's growing regional and global influence is the product of more sophisticated diplomacy and increased Chinese economic power. Chinese diplomats have learned

how to operate effectively in both bilateral and multilateral settings. China's increasing global economic and diplomatic presence will complicate U.S. diplomatic efforts at the bilateral, regional, and global levels.

China's pragmatic, nonideological approach to bilateral relations (provided countries accept the PRC position on Taiwan) provides foreign governments with an alternative to dependence on the United States, thereby reducing U.S. influence in many countries. China cannot match the U.S. ability to deliver or deny economic and diplomatic benefits on a global basis. But by providing countries with a partial alternative, Beijing gives them increased leverage in dealing with Washington on a range of issues. China's willingness to deal with states that have autocratic or corrupt leaders (such as North Korea, Burma, Sudan, and Zimbabwe) without political conditions will make it more difficult for the United States to isolate these regimes and press their leaders to undertake anticorruption measures or political reforms. Efforts by the U.S. Government and U.S. nongovernmental organizations to engage China's foreign aid bureaucracy in a dialogue on "best practices" in foreign aid could be one way of mitigating some of these concerns.

China's interactions with regional organizations around the world will complicate U.S. regional diplomacy and make it harder to engage regional organizations in support of U.S. objectives. Chinese leaders appear to be conscious of U.S. sensitivities about Chinese involvement in the Middle East and Latin America, which may restrain their diplomatic initiatives in these regions. China will find it easier to increase its influence in regions or countries that are not top priorities for the United States (such as sub-Saharan Africa). This may set up a competitive dynamic where the United States feels pressure to increase the attention and resources it devotes to countries and regions that would otherwise be considered low priorities.

Asia is a special case where China's increasing regional activism and influence could conflict with important U.S. interests. In recent years, China has started or supported a variety of regional initiatives that do not include the United States. Some view this as evidence of increasing Sino-U.S. competition for influence in Asia, with both countries trying to strengthen ties with key Asian states. China's preference for regional institutions that do not include the United States raises concerns that Asian regionalism could evolve in a direction that undermines U.S. alliances and locks the United States out of the region. However, Asian countries want the United States to remain actively engaged in Asia to balance Chinese influence. The United States has considerable hard and soft power resources and is well positioned to compete effectively with China if necessary.

China's increased influence in international organizations will complicate U.S. efforts to pursue a global agenda that includes democracy promotion, human rights, and labor issues. Beijing can use its self-proclaimed position as a leader of the developing world to mobilize opposition to initiatives that it views as contrary to its economic or political interests. China is likely to continue its principled opposition to military intervention on humanitarian or security grounds, but its increased diplomatic influence may make it more difficult for the United States to work around Chinese objections than in the past. China's diplomatic opposition to sanctions (and willingness to deal directly with leaders of repressive regimes) will make it harder to isolate and pressure countries, especially if the United States or other countries become concerned about Chinese influence in those countries. This dynamic is already operating in Burma, where India has begun dealing directly with the government without raising human rights issues.

Economic Implications. China's rapid economic growth (and accompanying demand for energy and natural resources) will have direct and indirect effects on U.S. economic interests. These effects will occur through China's impact on global prices, competition for market access, and bearing on

global economic rules. China's growing weight in a globalized world economy will increase competition, which will work to the detriment of some U.S. companies and workers.

Increased Chinese demand contributes to higher global prices for oil, natural gas, and commodities ranging from copper to soybeans to cement. The first-order impact is higher prices for U.S. consumers and producers. A second-order impact is increased international competition to secure long-term access to resources. This competition is most acute in the energy sector, where China's national oil companies have actively pursued contracts around the world. Efforts to lock up supplies of equity oil did not succeed for Japanese oil companies and are unlikely to work for China in the long run. However, the short-term willingness of Chinese firms to secure access to energy and other natural resources at prices that are not commercially viable may make it difficult for U.S. firms to compete, especially given the opaque corporate structure of Chinese national oil companies and their likely access to state-subsidized loans. The United States could engage China and other countries in discussions about international rules for state financing and support for investment in energy resources, although China (like other late entrants into the international energy game) will be reluctant to give up these policy tools. Chinese multi-billion-dollar infrastructure and energy/mining investments are likely to increase global supplies of energy and other commodities, which will help mitigate price pressures. Efforts to engage the Chinese central government (and local governments) on improving energy efficiency are likely to be more successful (and may also provide commercial opportunities for U.S. companies).

Chinese competition with U.S. firms for markets in the United States and around the world will also have an impact on U.S. interests. China enjoys a position as the low-cost supplier of many manufactured goods, although many "Chinese" exports are merely assembled in China from imported components by foreign-owned companies. The percentage of value-added in China is often quite low. There is a high degree of complementarity between U.S. and Chinese exports, with American firms specializing in goods that are land-, technology-, and capital-intensive, while Chinese exports are mostly labor-intensive. Chinese exports mainly compete with goods from other Asian countries and developing countries.

Although the massive U.S. bilateral trade deficit with China has attracted much political attention in Washington, competition and market mechanisms are the best way to regulate trade. U.S. Government concerns should be focused on cases where Chinese government actions to subsidize inputs or influence currency values have a negative impact on U.S. companies or workers. Protection of intellectual property rights is another key issue, both within China and in competition for third-country markets. The Chinese government seeks to leverage market access as a tool in trade negotiations; the United States can also play this game successfully.

A third area where China's increasing influence is likely to affect U.S. economic interests is in setting global economic rules. Asian countries currently have less influence in international financial institutions than the size of their economies warrant. To date, China has identified itself as a developing country and been reluctant to participate actively in global economic institutions such as the Group of Eight and the International Monetary Fund (even though many of its international economic interests are more aligned with developed countries than with developing countries). This partly explains China's relatively passive position in the Doha round of global trade talks. However, as China's economy grows, Beijing is likely to seek an increased role in setting economic rules. The impact on the United States will vary: on some issues (tariff reductions, protection for investments), Beijing and Washington are likely to find common ground; on others (industrial policy, state subsidies), positions are likely to be opposed. In any case, China will clearly become a more important factor in U.S. economic diplomacy.

Security Implications. With the exception of China's nuclear arsenal, its traditional power projection capabilities outside Asia remain limited. China's military capabilities and influence within Asia are increasing, but the PLA still has a very limited impact outside the region (mainly through military diplomacy, participation in peacekeeping operations, and arms sales). China's ambitious military modernization efforts are likely to improve the PLA's capability to project power globally, but this will be a gradual, long-term process. However, increased Chinese military capabilities—and especially power projection capabilities—are likely to stimulate Asian and U.S. concerns about Chinese long-term intentions.

One question is whether China's expanded global interests will be used to justify efforts to build the PLA into a force capable of global operations. In the early 1990s, Chinese strategists sought to use the need to defend China's sovereignty and resource claims as the justification for increased military spending.⁷⁴ These arguments faded as Taiwan's perceived moves toward independence became an accepted rationale for annual double-digit increases in defense spending. There are some indications that PLA strategists are beginning to look beyond the Taiwan issue and articulate the rationale for building a Chinese military capable of global operations.⁷⁵ The need to defend China's SLOCs would be a key argument in this debate. Chinese efforts to build a blue-water navy capable of dominating Asia or projecting naval power outside the region would affect U.S. freedom of action and likely be viewed in highly negative terms by the United States.

Conclusion

China's global activism (and the mix of economic and strategic motives driving it) merits careful attention and analysis. However, China's increased influence also needs to be kept in perspective. Chinese military power projection capability remains limited; Chinese businesses are taking their first steps in efforts to become global multinationals. China is an export powerhouse, but 60 percent of its exports are produced by foreign invested firms. Chinese global influence is increasing, but China still operates within the framework of global institutions established by the United States.

Deputy Secretary of State Robert Zoellick is correct when he argues that China has been a major beneficiary of the existing international system over the last 25 years and that China needs to take more responsibility for sustaining this system.⁷⁶ The United States should look for opportunities to influence Chinese definitions of global interests and attitudes toward international norms in positive directions. China's increasing regional and global activism will inevitably affect U.S. interests, sometimes in negative ways. Some aspects of U.S.-China relations are likely to be competitive, but the relationship is not a zero-sum competition. The United States and China have both common and conflicting interests, and there is considerable scope for cooperation at the bilateral, regional, and global levels. Engagement and dialogue are critical aspects of U.S. efforts to turn China into a responsible stakeholder that will play a positive global role.

Sources and Methodology

Much of the underlying data for this report was compiled by a team of contractors and research assistants working under the supervision of Dr. Phillip C. Saunders and research coordinator Daniel Melleby. The researchers were assigned to different regions and followed a detailed research protocol designed to ensure data comparability across regions. Some data (such as China's trade statistics and outbound foreign direct investment) was collected centrally for all regions. Sources for most specific statistics and references are cited using endnotes.

Trade data is from the United Nations Commodity Trade Statistics Database (UNCOM-TRADE) online, available at <unstats.un.org/unsd/comtrade/default.aspx>. Chinese trade data from this source is derived from Chinese customs statistics and does not accurately account for goods imported and re-exported through Hong Kong.

Chinese inbound FDI was obtained from various editions of the *Almanac of China's Foreign Economic Relations and Trade* and the *China Statistical Yearbook*. Chinese outbound FDI data for 1992–2004 was obtained from the *China Commerce Yearbook* (prior to 2004, the *Yearbook of China's Foreign Economic Relations and Trade*) published annually by the Ministry of Commerce. Except for aggregate totals, most outbound figures and percentages exclude FDI in China's special administrative regions Hong Kong and Macao and FDI transiting FDI havens Bermuda, the Cayman Islands, and the Virgin Islands to other destinations.

Information on Chinese diplomatic agreements and leadership travel was compiled from a variety of sources. The starting point was various editions of the Ministry of Foreign Affairs annual book *China's Foreign Affairs* (Beijing: World Affairs Press). Both Chinese and English editions were used. This source was supplemented by targeted FBIS, Lexis, and Google searches.

Aggregate total data for Chinese foreign assistance is taken from the 2003–2005 editions of the *China Statistical Yearbook*. Researchers also used targeted FBIS and Lexis searches to collect details of Chinese assistance to particular countries and for particular projects.

Chinese infrastructure data was collected from comprehensive searches in Lexis-Nexis and the Open Source Center/FBIS. The year listed next to a project signifies either when the project was initially proposed or the date of the project's completion.

Values of Chinese infrastructure investments and foreign assistance were occasionally cited in currencies other than U.S. dollars. OANDA.com (<http://www.oanda.com/convert/fxhistory>) was used to provide historic currency conversion rates between the cited currency and the U.S. dollar on the date of the open source article which cited the non-dollar amount, or as close to it as possible if an exchange rate was not available on that particular day. All valuations are in current, not constant, dollars.

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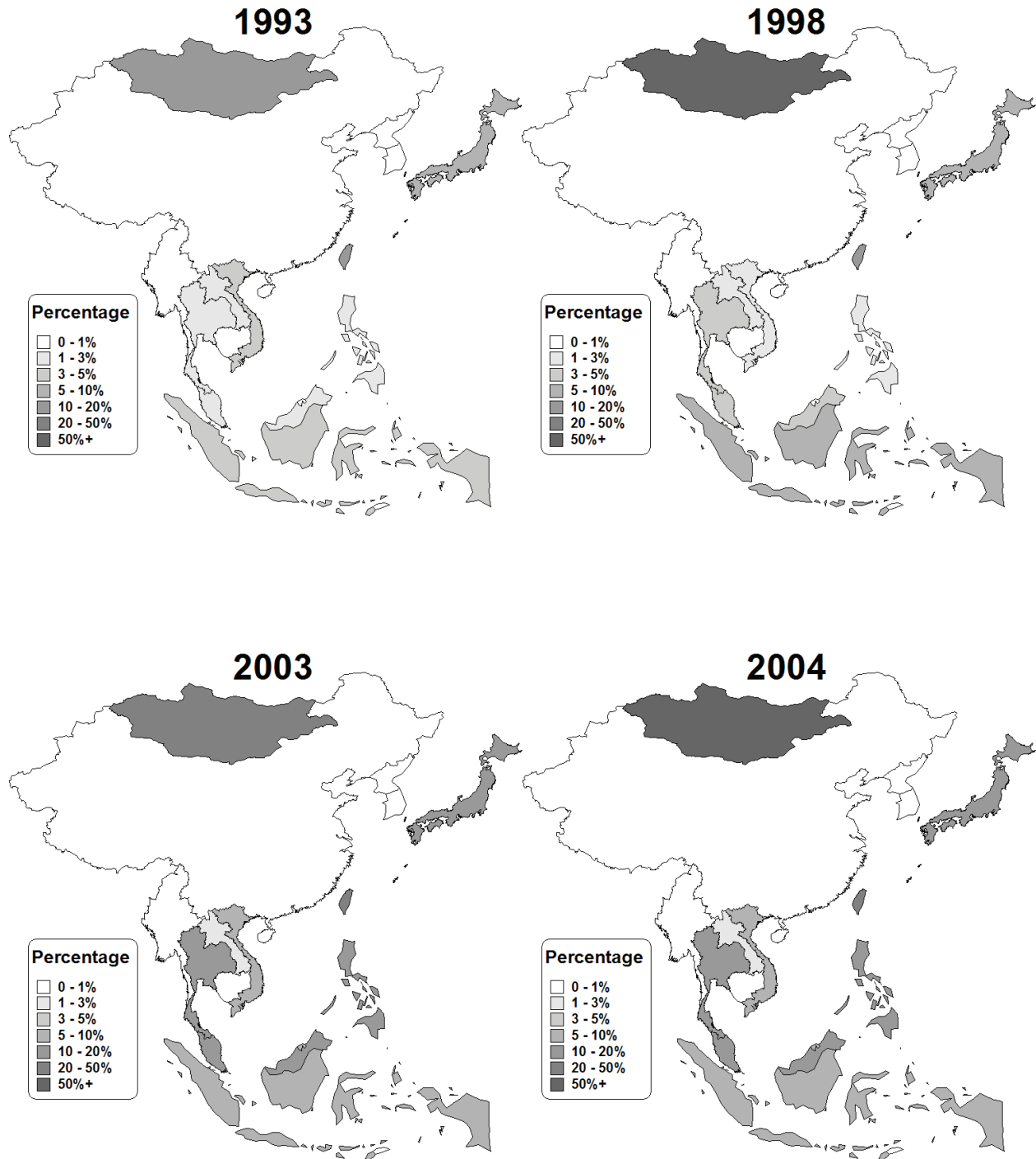
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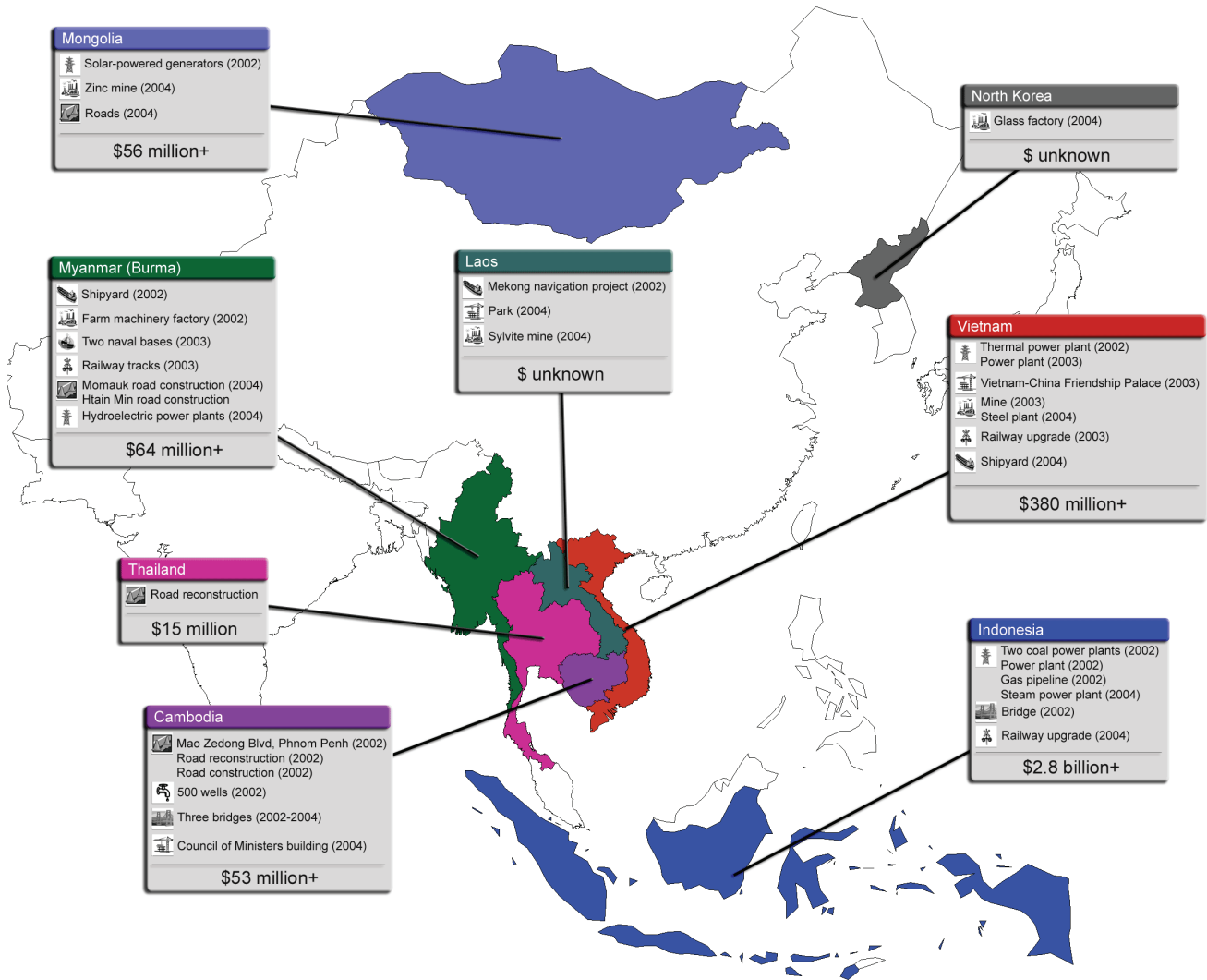
Appendix: Regional Data



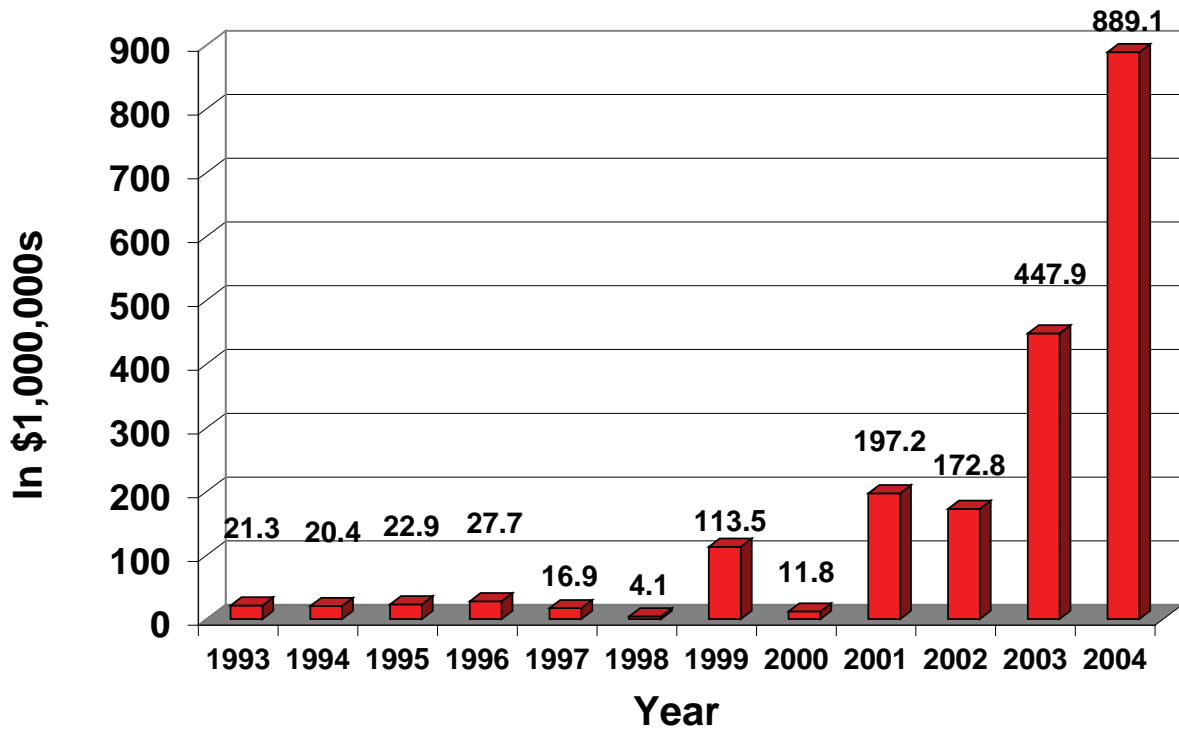
Total Exports Destined for China from Asia



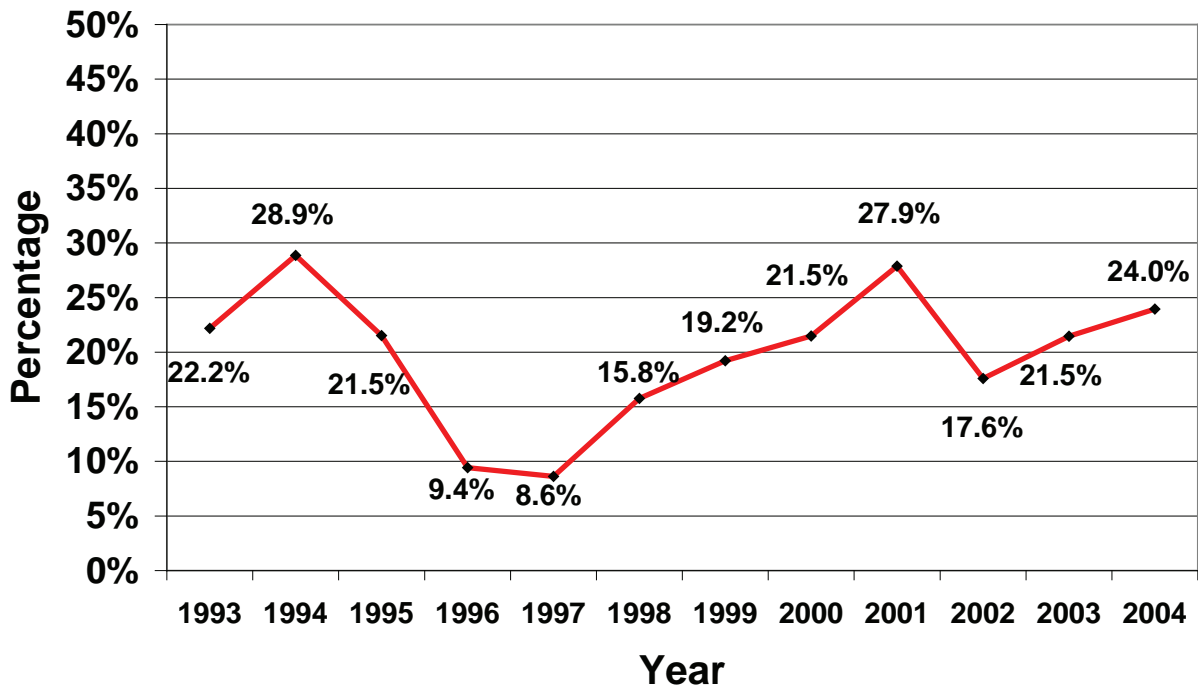
Chinese Infrastructure Projects in Asia



PRC FDI to Asia Excluding SARs

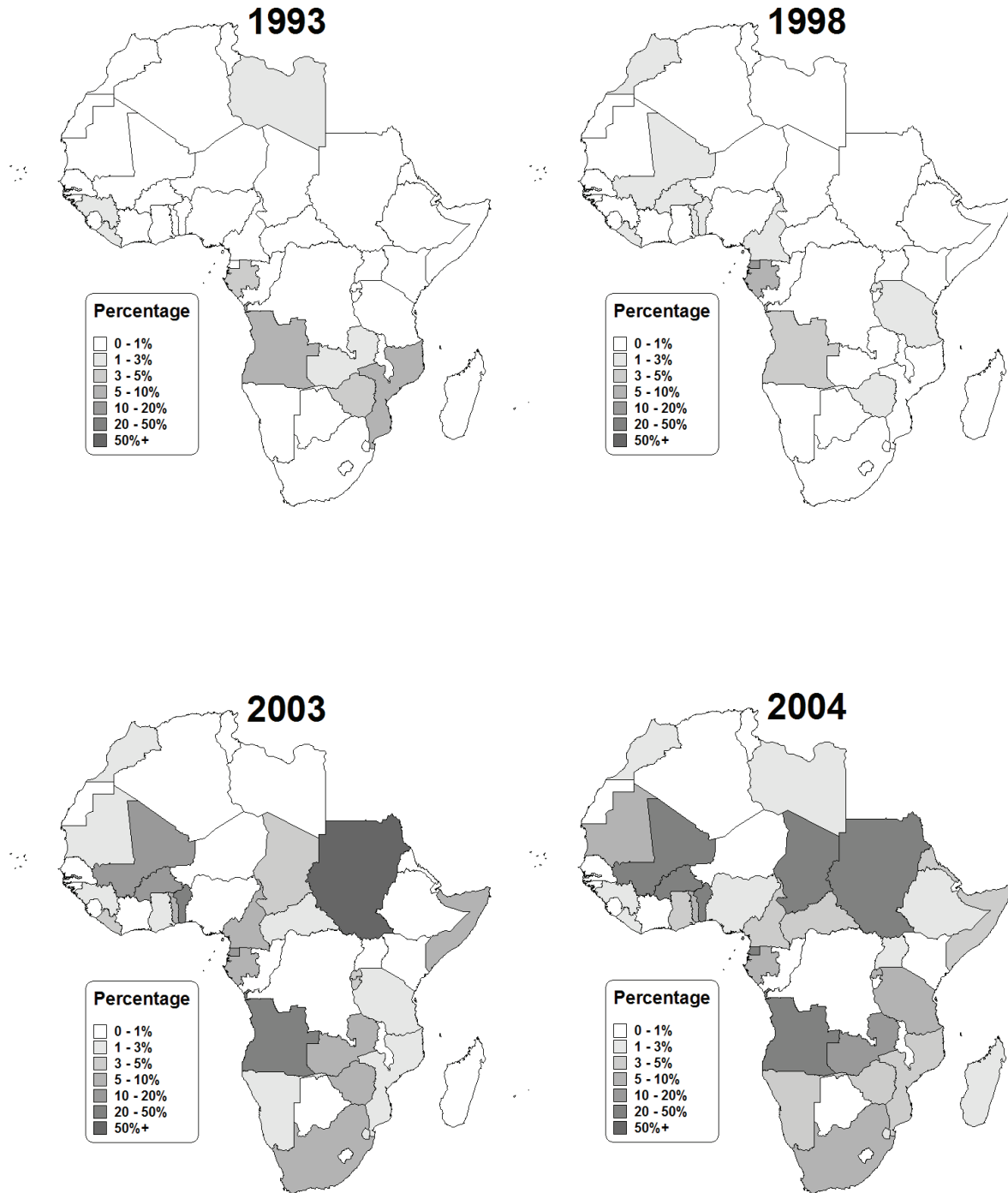


Asia % of Total PRC FDI

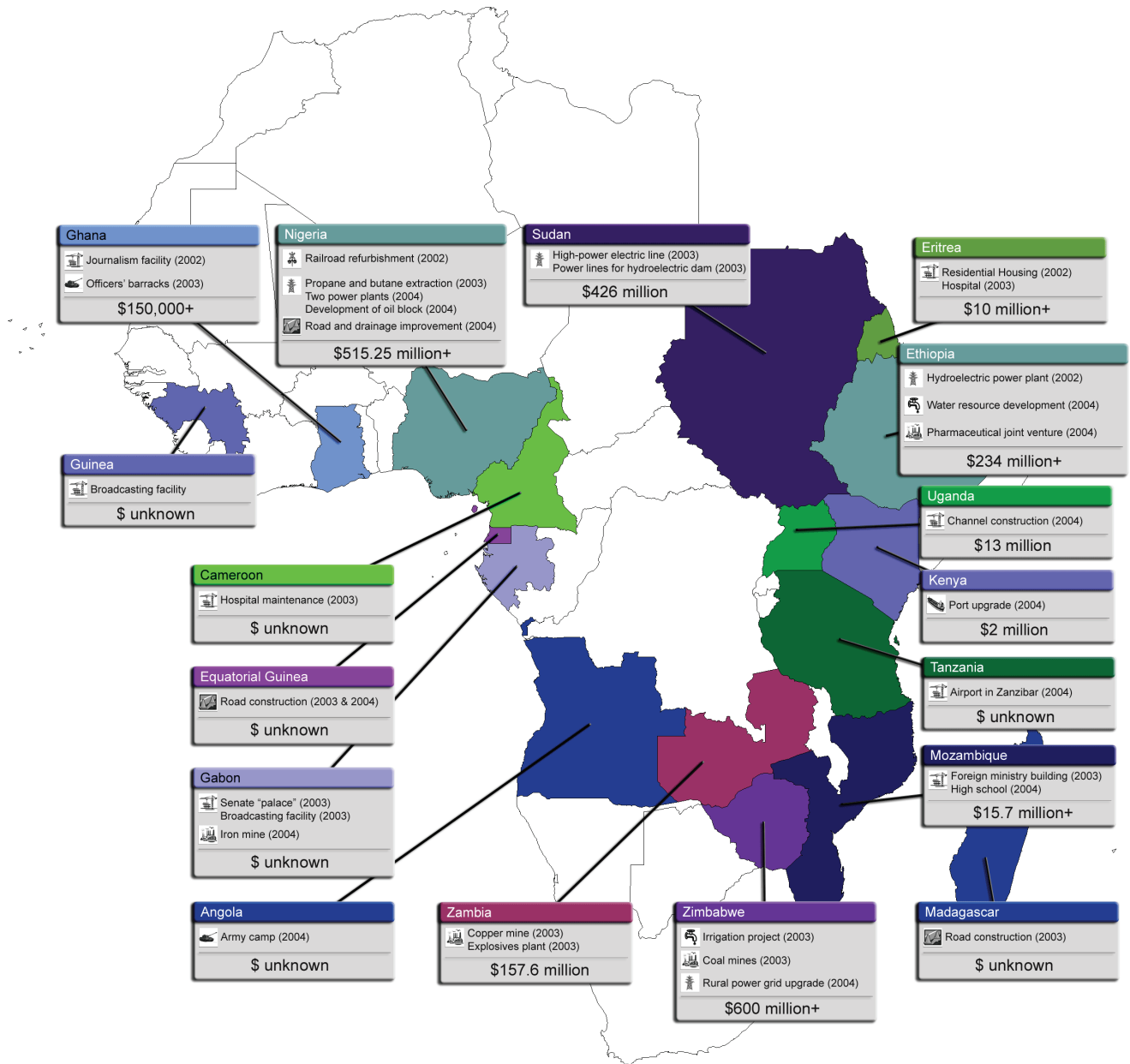




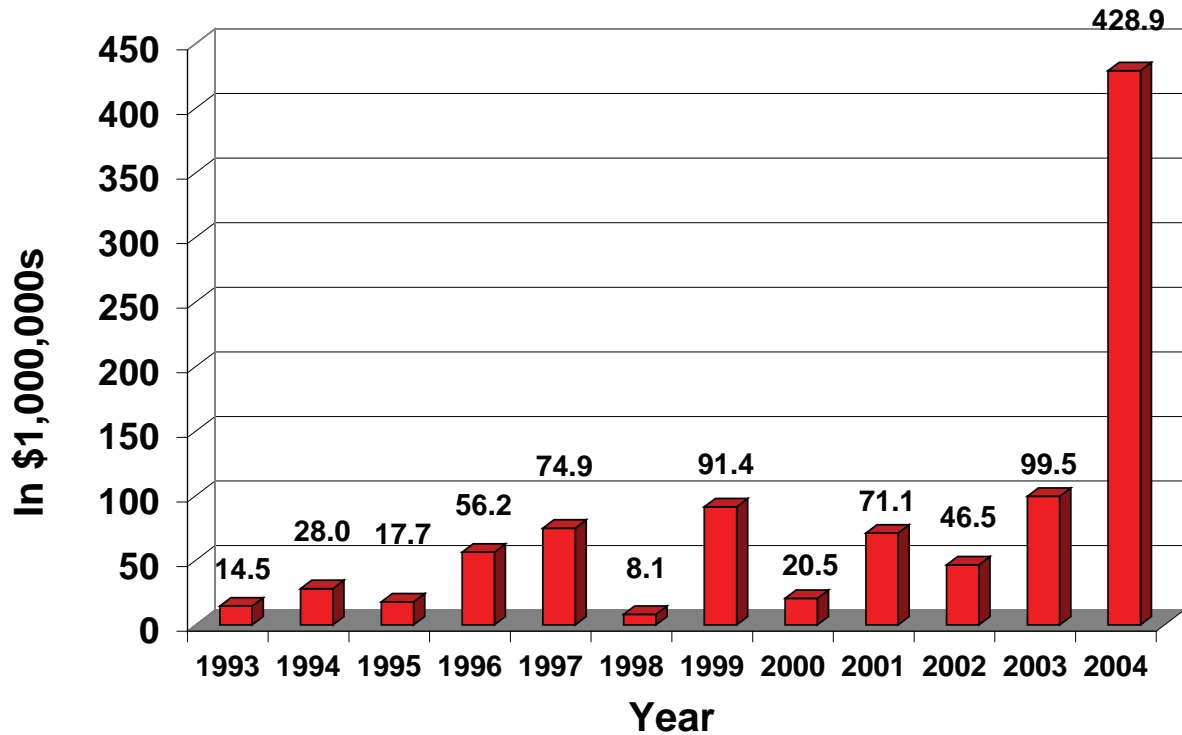
Total Exports Destined for China from Africa



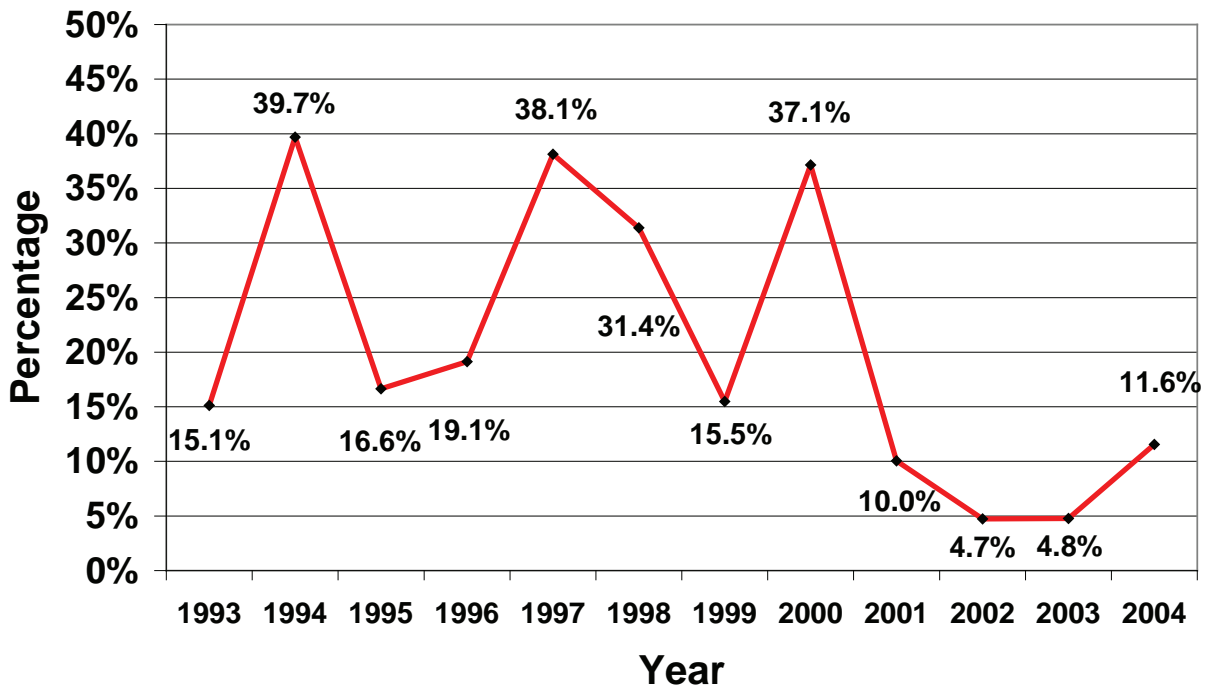
Chinese Infrastructure Projects in Africa



PRC FDI to Africa



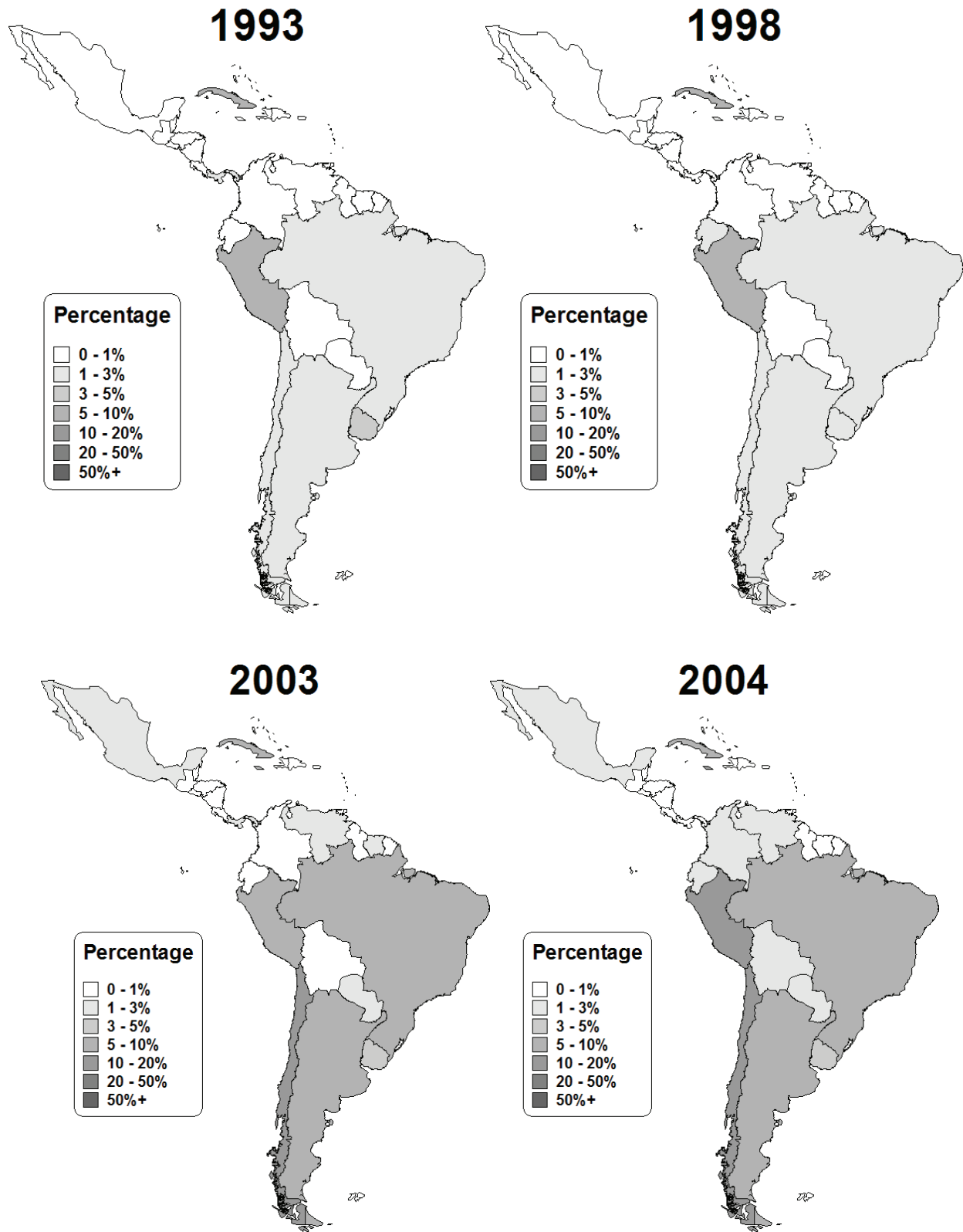
Africa % of Total PRC FDI



Latin America



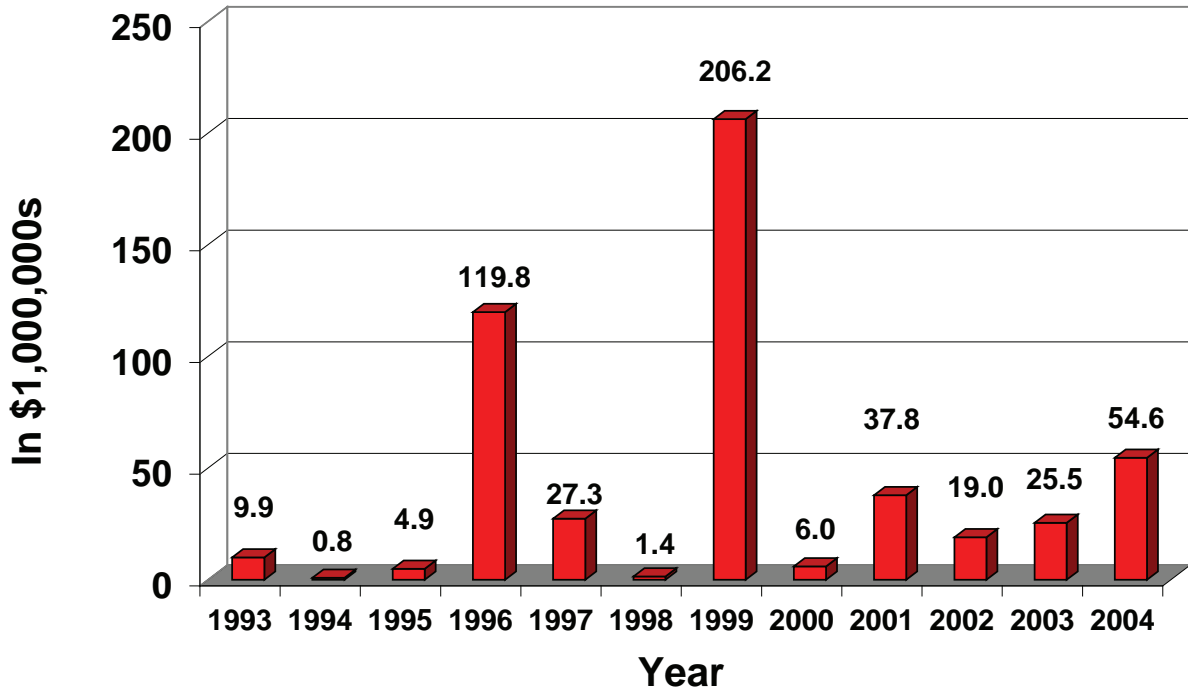
Total Exports Destined for China from Latin America



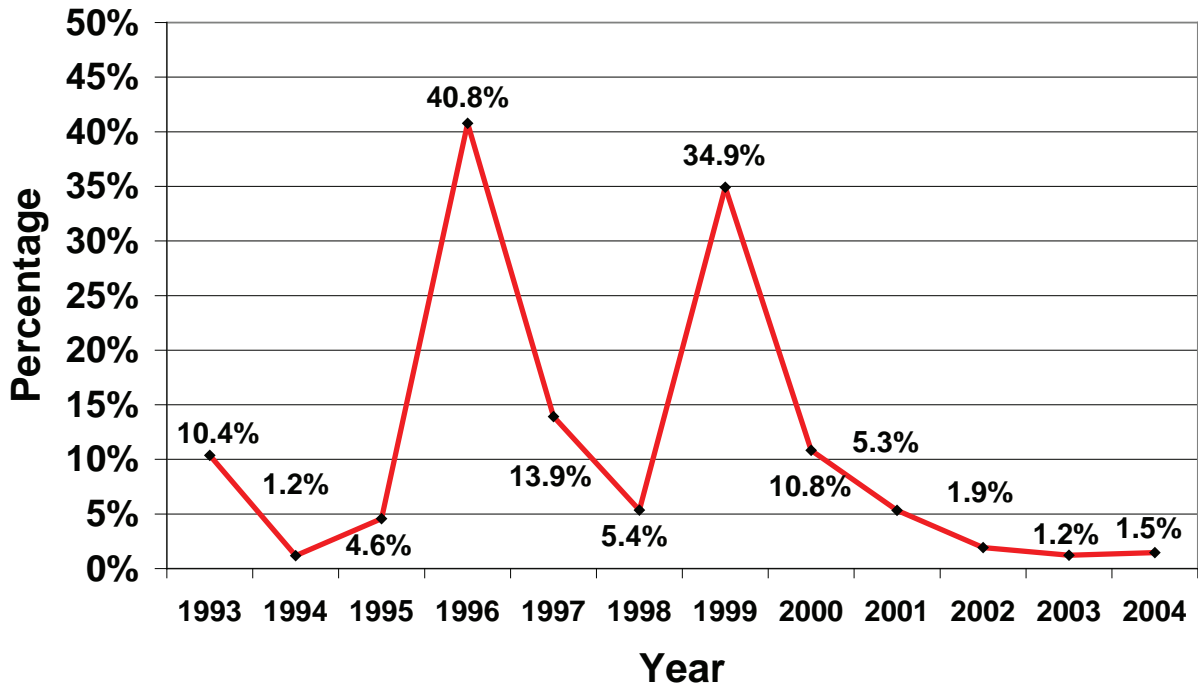
Chinese Infrastructure Projects in Latin America



PRC FDI to LatAm Excluding FDI Havens



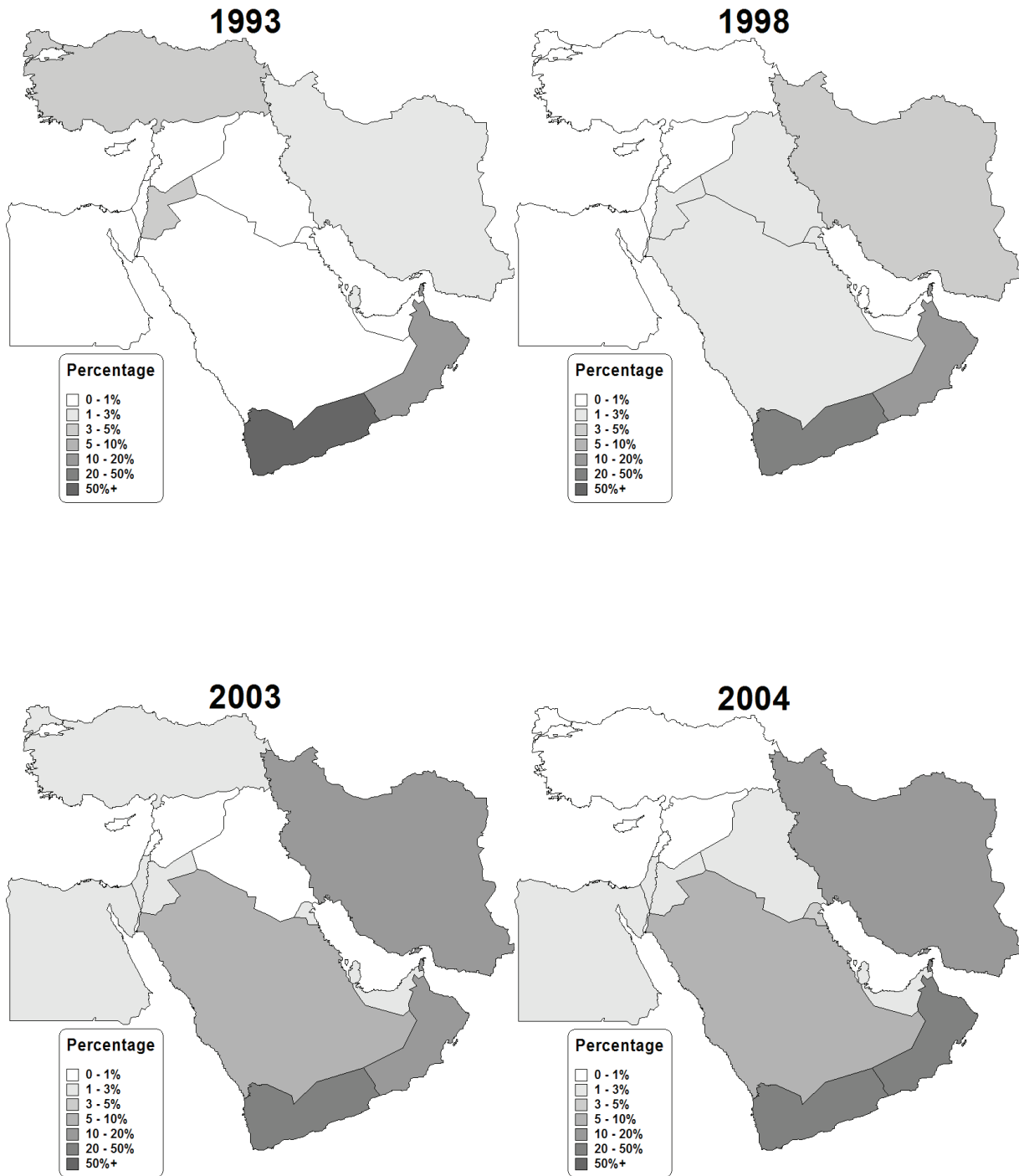
LatAm % of Total PRC FDI



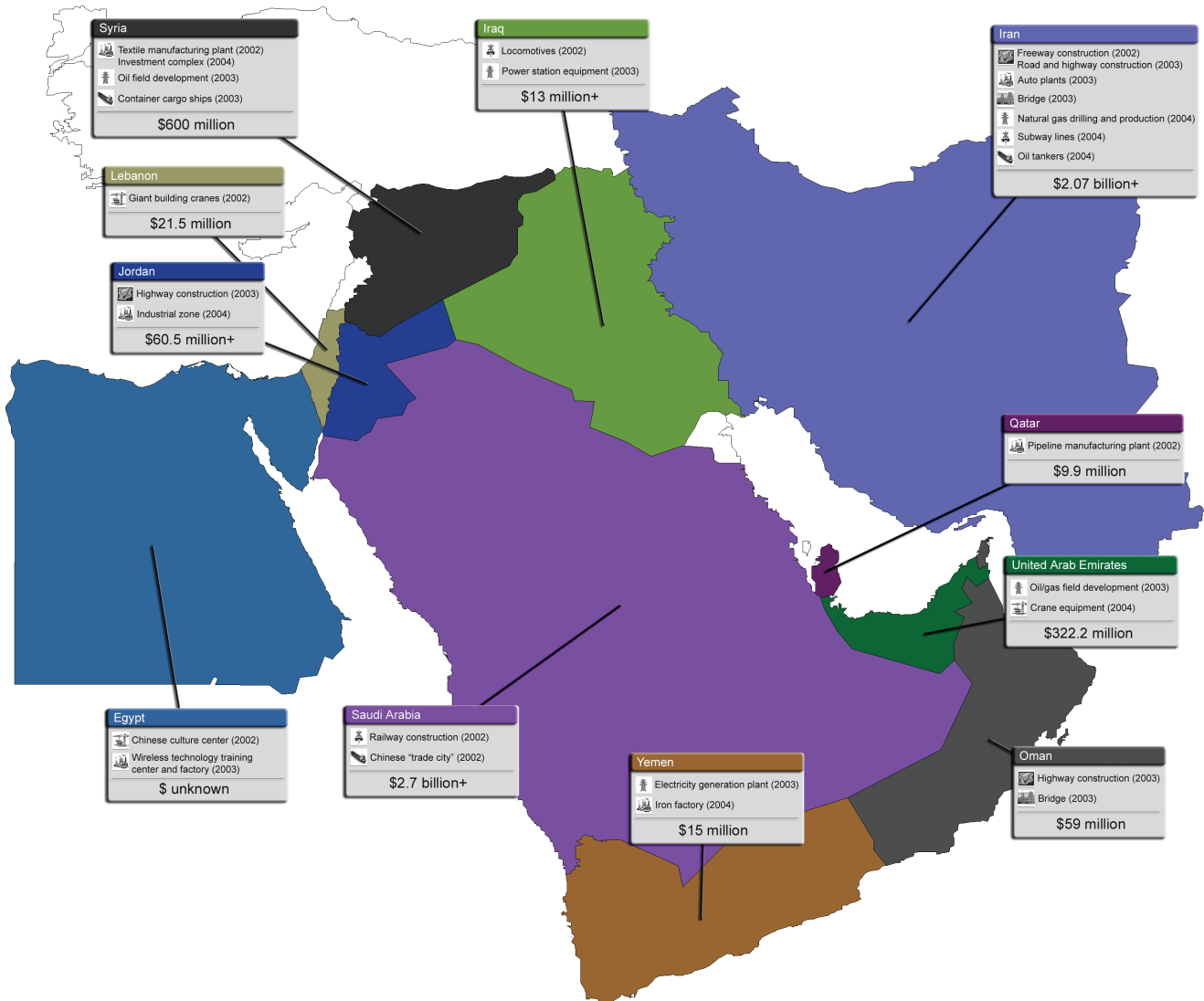
The Middle East



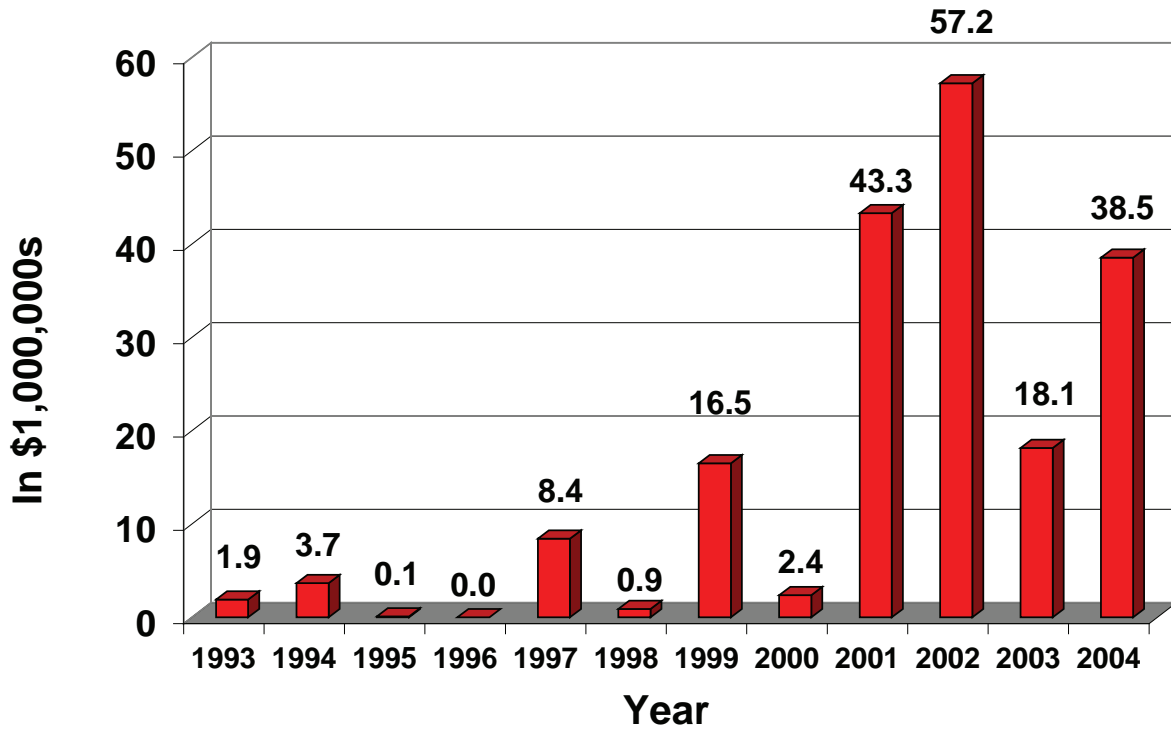
Total Exports Destined for China from Middle East



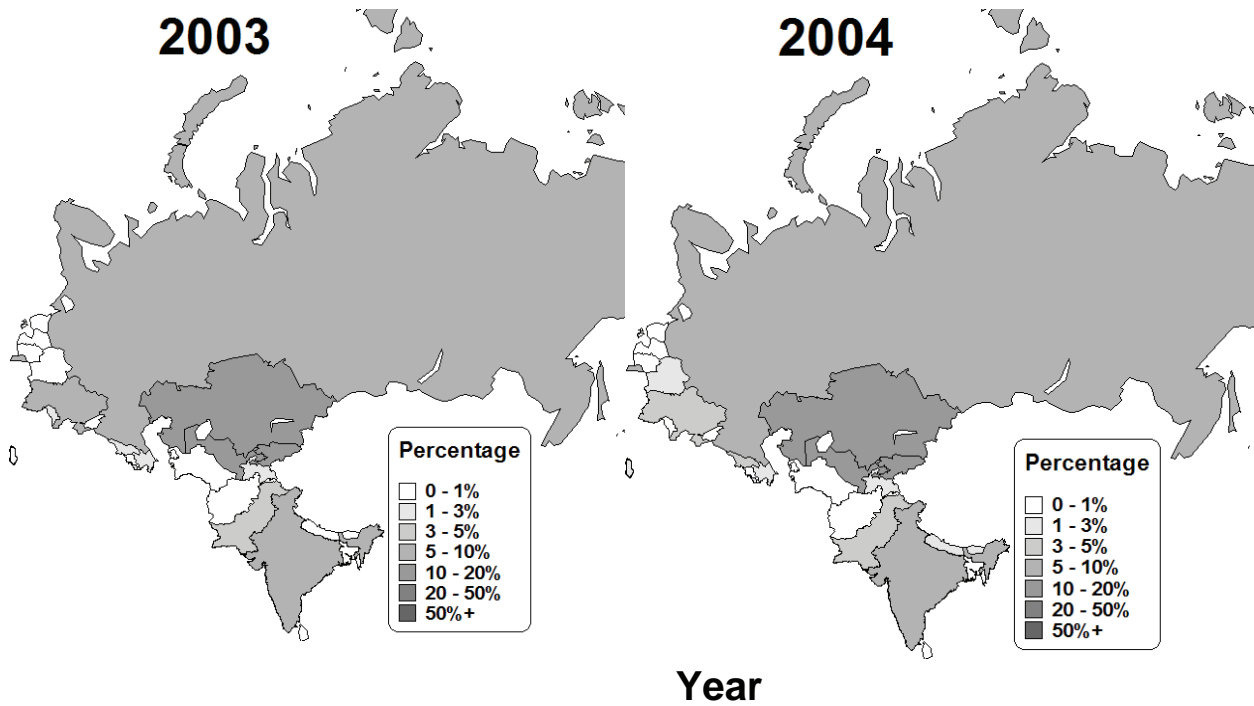
Chinese Infrastructure Projects in the Middle East



PRC FDI to MidEast



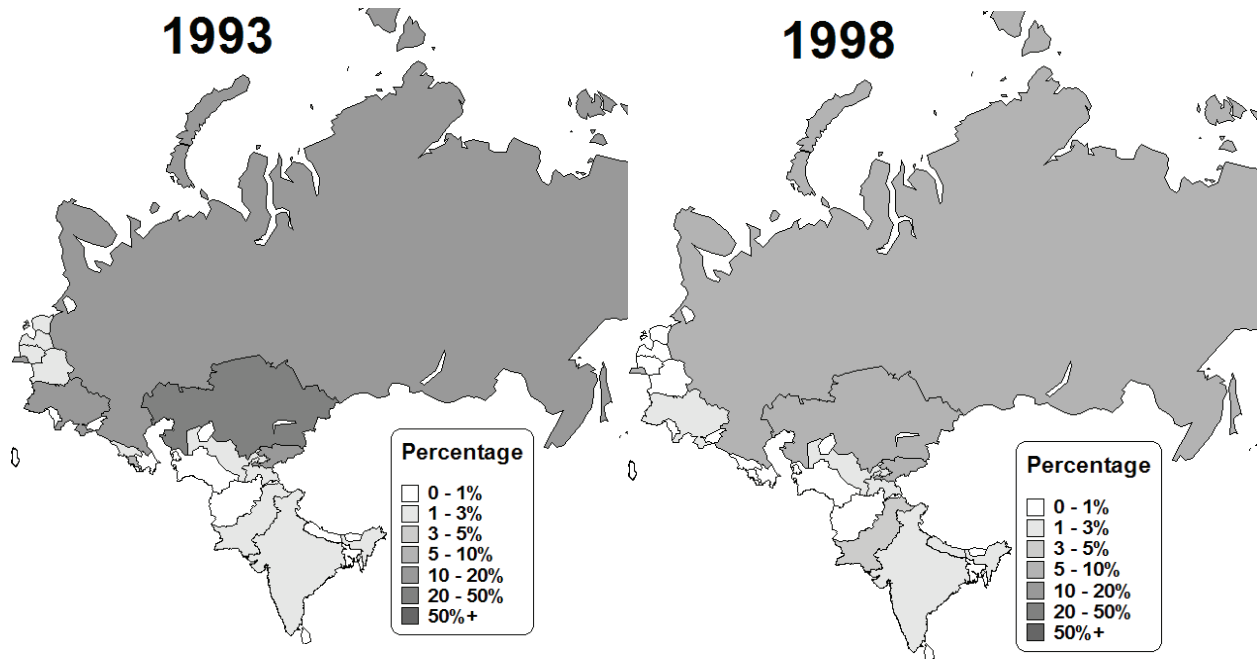
MidEast % of Total PRC FDI



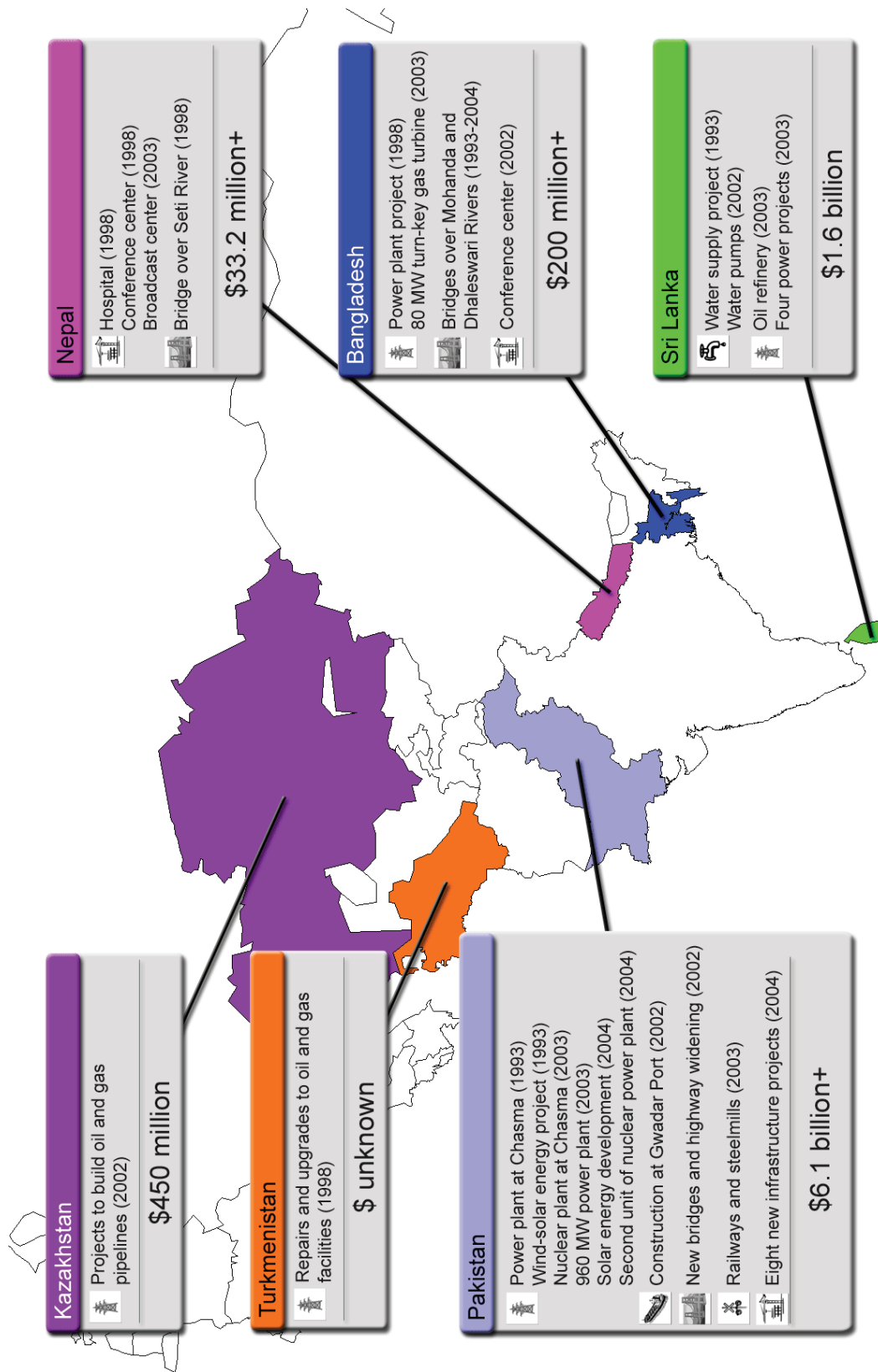
The Former Soviet Union and South Asia



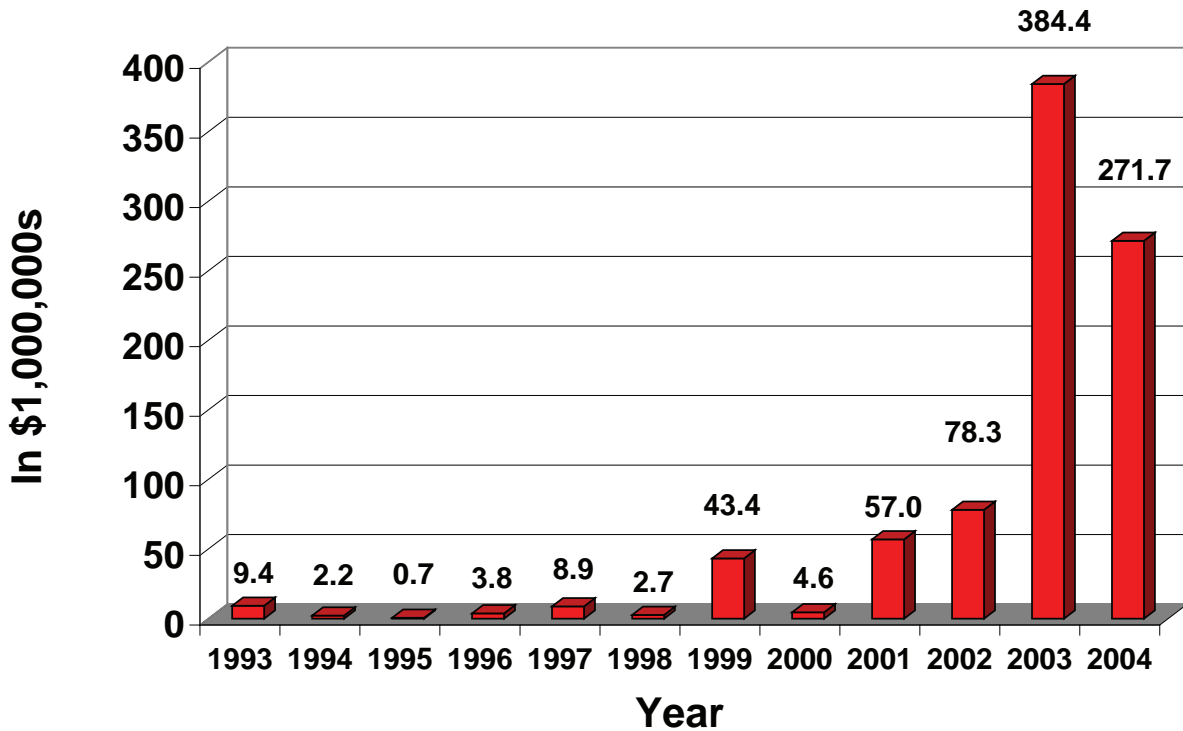
Total Exports Destined for China from the FSU and South Asia



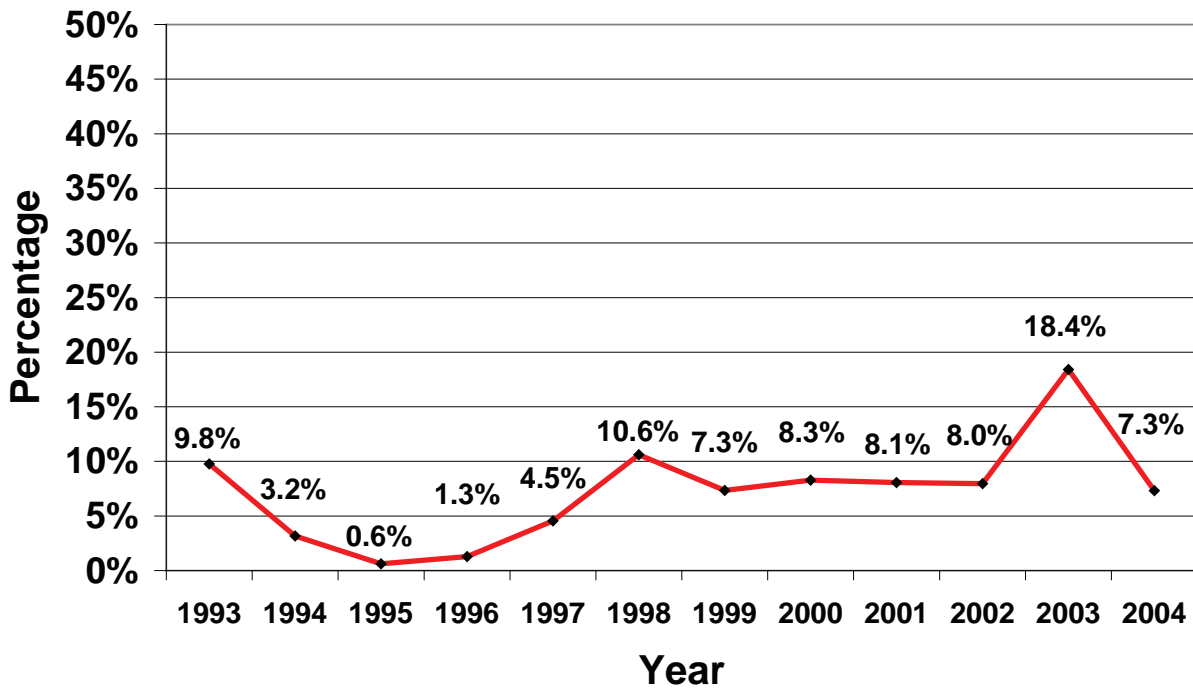
Chinese Infrastructure Projects in the FSU and South Asia

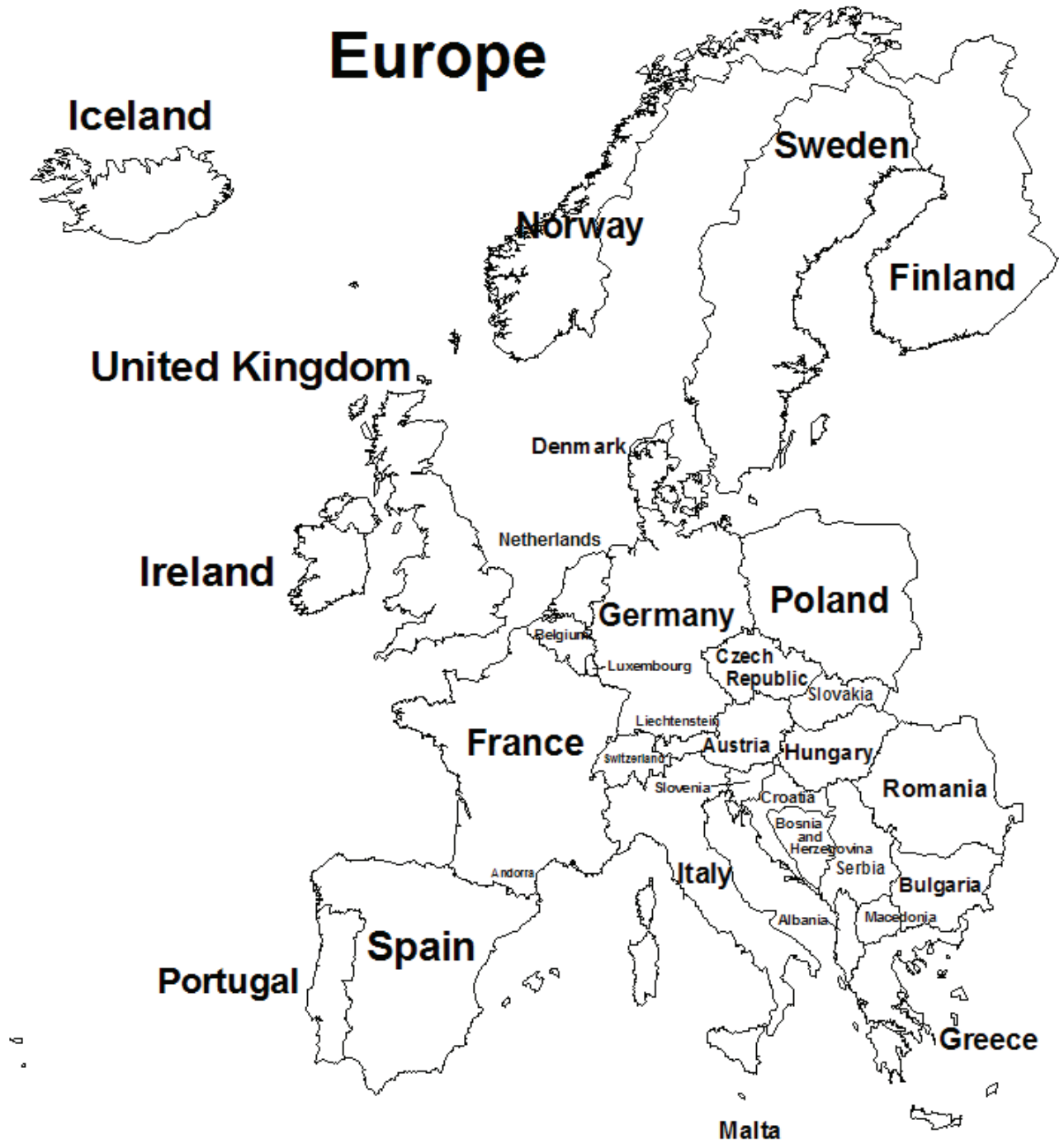


PRC FDI to FSU and S Asia

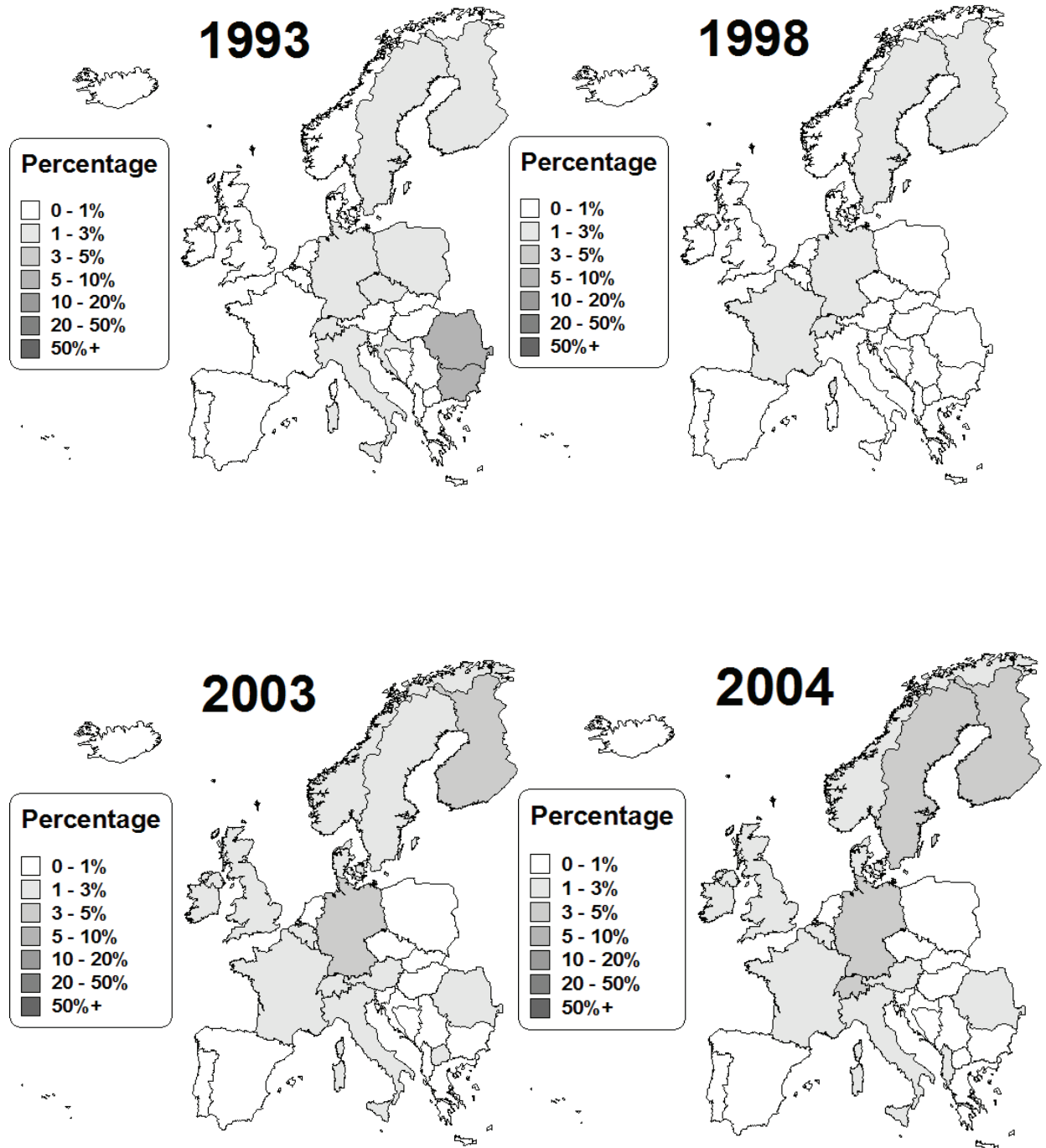


FSU and S Asia % of Total PRC FDI

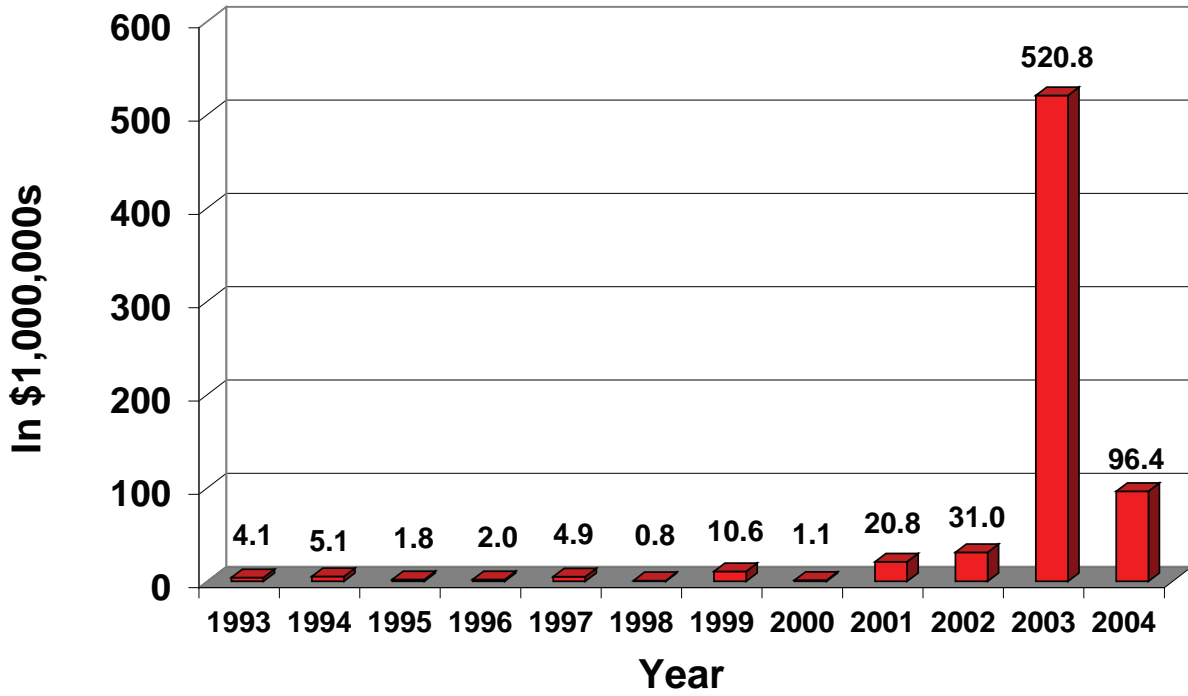




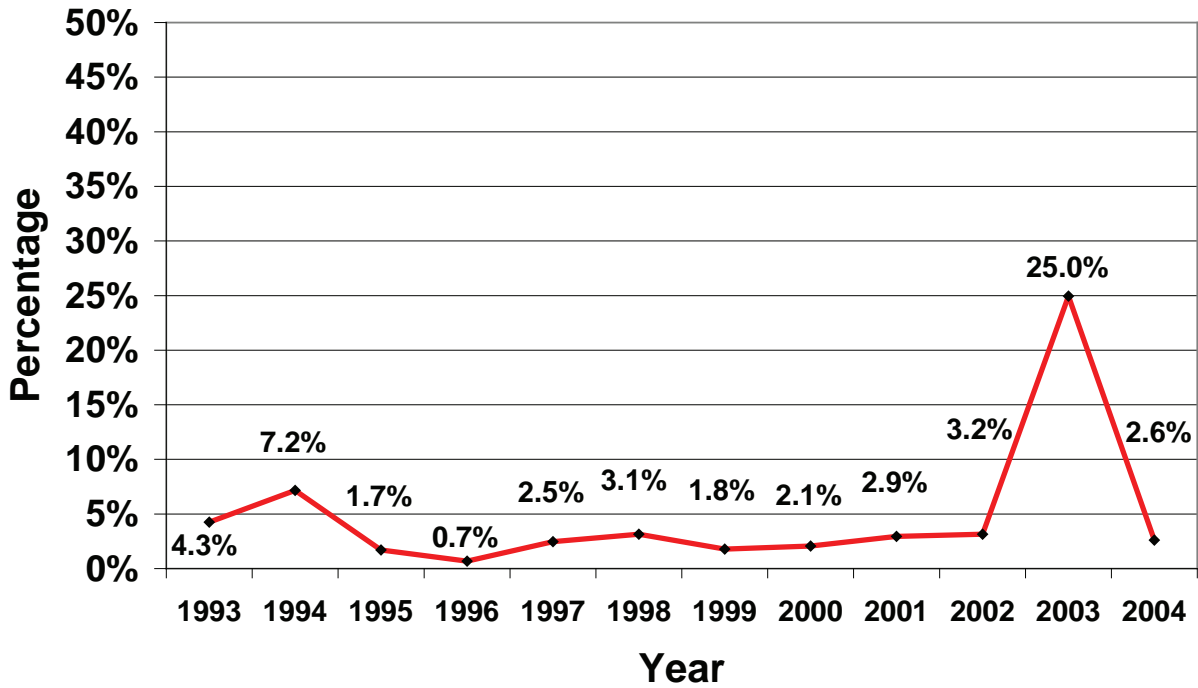
Total Exports Destined for China from Europe



PRC FDI to Europe



Europe % of Total PRC FDI



About the Author

Phillip C. Saunders has been a Senior Research Fellow in the Institute for National Strategic Studies at the National Defense University since January 2004. He conducts research on China and on a range of East Asian security issues. Dr. Saunders recently co-organized a highly successful seminar and conference series examining Chinese influence in Asia in conjunction with the American Enterprise Institute. He has also organized and participated in a wide variety of roundtables, conferences, and seminars on Asian security.

Dr. Saunders previously worked at the Monterey Institute of International Studies, where he served as Director of the East Asia Nonproliferation Program at the Center for Nonproliferation Studies from 1999 to 2004 and taught courses on Chinese politics, Chinese foreign policy, and East Asian security. While at Monterey, he organized a variety of training programs on arms control, nonproliferation, and international security for East Asian government officials, military officers, and scholars.

He has conducted research and consulted on East Asian security issues for Princeton University, the Council on Foreign Relations, RAND, and the National Committee on U.S.-China Relations. From 1989 to 1993, he served as an officer in the U.S. Air Force. He was assigned to the Pentagon, where he worked as a staff officer on Asian policy issues.

Dr. Saunders has published numerous book chapters and articles on China and Asian security in journals including *International Security*, *China Quarterly*, *The China Journal*, *Survival*, *Asian Survey*, *Pacific Review*, and *Orbis*. His recent publications include “Long-Term Trends in China-Taiwan Relations: Implications for U.S. Taiwan Policy” in *Asian Survey*; “China’s Strategic Force Modernization,” in *China’s Nuclear Future* (ed. Albert Willner and Paul Bolt); and “Korea as viewed from China,” in *Korea: The East Asian Pivot* (ed. Jonathan Pollack).

Dr. Saunders speaks Mandarin Chinese and has traveled throughout Asia. He attended Harvard College, where he graduated with a *summa cum laude* degree in history. He received his MPA, MA, and PhD in International Relations from the Woodrow Wilson School at Princeton University. His current research projects include Chinese influence in East Asia; Deterrence and U.S. Alliances in Asia; and a book-length study examining China’s global activities.