

CHINA'S GROWING GLOBAL INFLUENCE: OBJECTIVES AND STRATEGIES

HEARINGS BEFORE THE U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION ONE HUNDRED NINTH CONGRESS FIRST SESSION

—————
JULY 21 AND 22, 2005
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Printed for the use of the
U.S.-China Economic and Security Review Commission
Available via the World Wide Web: <http://www.uscc.gov>



U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

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The Commission's Statutory Mandate begins on page 298.

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

DECEMBER 6, 2005

The Honorable TED STEVENS,
President Pro Tempore of the U.S. Senate, Washington, D.C. 20510
The Honorable J. DENNIS HASTERT,
Speaker of the House of Representatives, Washington, D.C. 20515

DEAR SENATOR STEVENS AND SPEAKER HASTERT:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the record of our July 21–22, 2005 public hearing in Washington, D.C. This hearing on “*China’s Growing Global Influence: Objectives and Strategies*” provided revealing insights into China’s increasing global reach. An electronic copy of the hearing record is posted to the Commission’s Web site at www.uscc.gov.

As you know, the Commission is mandated by Congress to analyze and assess the economic and security dynamics between the U.S., Taiwan, and China (P.L. 108–7, Division P, Sec. 2(c)(2)(F)) and to evaluate how China’s growing economy affects world energy supplies (P.L. 108–7, Division P, Sec. 2(c)(2)(C)).

The Commission heard from Senators Russell Feingold and James Inhofe and Representative J. Randy Forbes and from leading experts outside government regarding China’s global objectives, energy strategy, and approaches to certain regions of the world.

The hearing was timely as the Chinese government and many Chinese commercial firms are increasing their ties to all regions of the world. Shortly before our hearing, the Beijing government, in an attempt to lessen Washington’s influence near its border, called on the United States to set a withdrawal deadline for its forces stationed in Central Asia in pursuit of the war on terror. Moreover, the Chinese oil firm China National Offshore Oil Corporation (CNOOC) was in the midst of its later-abandoned campaign to acquire the U.S. oil company Unocal, raising serious U.S. national security concerns.

China’s Global Strategy and Growing World Presence

From West Africa to South America, China’s presence and influence are growing. Currently, China is reaching out around the world in an attempt to secure markets for its exports, to access minerals, raw materials, and oil for its fast growing economy, and to increase its international stature while isolating Taiwan. In doing so, China has demonstrated it is willing to cultivate relationships with countries such as Sudan and Iran that are engaged in objectionable political, human rights, or proliferation behavior. In this way the PRC acts as a diplomatic counterweight to nations including the United States that have criticized the undesirable activities and the governments engaged in or condoning them.

China’s current efforts to secure immediate objectives suggest that China is seeking, and will continue to seek, a stronger world leadership role and consolidation of its recent gains. There is little doubt that the country currently is laying the groundwork for en-

hanced diplomatic, economic, and military relations around the globe. It now has the ability to pursue these objectives because, as Dr. Marvin Ott testified, "... freed from the traditional strategic threats posed by Japan and Russia ... China for the first time since the height of the Ming Dynasty [is] strategically free to begin to assert itself internationally."

Witnesses testified that China's foreign policy has changed dramatically over the last ten years in response to the status of the United States as the lone remaining superpower. It has, as one witness noted, become much more proactive, employing a much more creative diplomacy. In an attempt to increase its profile vis-à-vis the United States, and to secure new energy sources, China is increasing its use of investments and development packages to win favor and contracts, in places like West Africa and Latin America. According to former U.S. Ambassador to Nigeria Princeton Lyman, China has returned to Africa not only with the need for economic resources but with a lot of cash to play the game dramatically and very competitively. Its economic success and rising capital reserves are significant reasons why China is able to conduct a broad diplomatic agenda that includes offering nations money, technology, and support in international fora.

To further its own interests, China also is willing to overlook the problems associated with despotic regimes and countries of concern, especially in connection with securing oil from Middle Eastern and African nations. For example, while many nations will not assist the governments of Sudan and Zimbabwe, Chinese companies sell weapons to the Sudanese and reportedly do the same to the Zimbabweans, while at the same time Chinese companies obtain access to the oil and minerals of these countries. As China's global influence grows, the United States needs to be attentive to its increasingly sophisticated approaches to other countries.

China's Energy Policies

China's accelerated economic development has required it to make a radical shift in its energy policies. To fuel its rapid growth and keep its economic engine humming, China is reaching out around the globe to secure energy resources. China's dramatic growth has driven it to deemphasize its former policy of relying primarily on domestic sources and purchasing foreign oil as needed, especially from the Middle East. In doing this, China is implementing a new two-pronged energy strategy that entails working to improve the efficiency of its domestic energy sector while at the same time seeking, as one expert explained, to aggressively secure access to international resources, preferably by securing access rights to physical production. Having watched the unfolding of the two Middle East conflicts in which the United States has been engaged in the past 15 years, China is concerned by its static domestic supplies and heavy reliance on Middle East oil. It recognizes the risks of becoming too reliant on any one region or country and is focused on establishing multiple sources so as not to put all its energy eggs in one basket. In searching for energy sources, China has approached a number of countries, including countries with which the United States has had longstanding relations such as Canada and Saudi Arabia, and countries with which the United States has

a strained or troubled relationship, such as Iran and Sudan. It has repeatedly demonstrated that it has no serious qualms about dealing with despotic regimes in order to fuel its own growth and stability.

Saudi Arabia is China's largest crude oil supplier. One witness encouraged Washington to closely examine this growing relationship: Saudi Arabia allows China to explore its natural gas fields, and the Saudi national oil company, Aramco, is now a significant investor in China's largest refinery. Undoubtedly, as Dr. Gal Luft explained, China would like to shift Riyadh's allegiance from Washington to Beijing, which could happen with further deterioration to the U.S.-Saudi relationship. The U.S. must attend to its own relationships with nations that traditionally have supplied it with oil to reduce American vulnerability to displacement by China.

As noted above, China also is reaching out to the Western Hemisphere, and particularly to Venezuela, for energy sources. Should China become a major purchaser of energy resources in the Americas, this could have significant strategic implications for the United States. According to one witness, this will make the United States more dependent on the Middle East and other volatile areas of the world for its oil; every barrel of oil that China buys in America, whether it is in North America, Central America, or Latin America, essentially means one less barrel available for the U.S. market.

China's quest for oil and gas has also led it to try to purchase directly a U.S. petroleum company—Unocal—by offering to pay more than the private market suggested it was worth. While CNOOC ultimately withdrew its bid, this attempt demonstrates the importance China attaches to improving its access to energy resources.

China's energy acquisition strategy differs from that of the United States and many other nations in that it wishes to own the underlying asset itself and appears willing, as the proposed CNOOC-Unocal transaction indicated, to pay a premium for the assets. While oil may be fungible, the fact that China's energy demands are rising so rapidly while world reserves remain fairly stagnant may force the United States to compete against other countries for a smaller piece of the pie as China protects the energy resources it acquires. Unlike a market economy, China may not be willing to sell the assets it acquires to the highest bidder. This could pose serious economic and, indeed, national security challenges for the United States.

China's Regional Activities

Africa

China's substantial interest in and relationships with African countries reach back to the African independence movements of the 1960s. But today a major goal of China's activities in Africa is the acquisition of raw materials it needs for its economy and African energy sources, particularly oil and gas. China obtains roughly one quarter of its oil from the continent and Africa is a vital source of other commodities for Chinese industry such as copper, iron, and timber.

China also is seeking—generally successfully—to expand other trade with African states. To facilitate this effort, China increasingly offers development projects and soft loans to African countries at the same time its companies are attempting to secure the trade agreements. According to one witness, this is a frequently successful tactic.

China has demonstrated repeatedly in Africa that it has no significant reservations about working with and propping up the regimes in countries like Zimbabwe and Sudan where authorities are involved in questionable activities or activities that are widely condemned. In an apparent exchange for the resources those countries are able and willing to make available to China, China offers their governments financial aid, diplomatic protection, and even, in some cases, weaponry. For example, Chinese companies have sold conventional weapons to Sudan. This Chinese assistance and support frequently frustrates the efforts of the United States and other nations to curb the objectionable behavior of such countries by thwarting universal international ostracism, satisfying some of their desires for products and services they cannot otherwise obtain, and, as one witness explained, protecting them from sanctions and other negative actions by the U.N. and other international organizations.

According to Ambassador David Shinn, inevitably, there is going to be an element of competition between China and the United States in Africa over access to natural resources, winning of commercial tenders, and even African support for occasional different positions on political, economic, and social issues in international fora. The United States should identify potential problems and make skillful use of diplomacy to reduce the risk of such conflict.

Europe

China's trade with Europe has been accelerating as it has been with all other regions of the world. China is currently the European Union's (EU) second largest trading partner and European companies have been eager to invest in China and access its growing domestic market. Not surprisingly, economic diplomacy between Brussels and Beijing is increasing and strengthening.

But, unlike the United States, the EU does not have a significant security component to its relationship with China or a defense commitment to Taiwan. As a result, European economic relations are largely unencumbered by national or regional security issues.

The EU established an arms embargo on China after the 1989 Tiananmen Square massacre. Congress and the executive branch have been active in calling on the EU to preserve the embargo. Until recently, support for maintaining this embargo, or lifting it, has rested predominantly on European human rights concerns. By early 2005, the EU was widely presumed to be marching inexorably toward lifting it by late 2005. However, after China passed its Anti-Secession Law focused on Taiwan in the spring of 2005, and with strong encouragement from both the Administration and the Congress, some European politicians realized the connection between the embargo and important global security interests, and the substantial momentum of the effort to lift the embargo was broken. The proposal was at least temporarily shelved. It is likely that,

after some amount of time passes, Europeans seeking improved diplomatic relations and more economic opportunities with China, spurred by China's efforts to purchase European arms and arms-related technology, will resurrect the proposal to repeal the embargo.

Latin America

There are striking similarities between China's approach to Latin America and its approach to Africa. As is the case with Africa, the United States has no apparent coordinated and comprehensive strategy pertaining to China's increasing activity in the Western Hemisphere, and therefore no basis for policy responses to that activity.

China is a dynamic new presence in Latin America. According to Dr. Cynthia Watson, "Latin America's perception of the relationship with the United States is that there's a vacuum there. I think Latin America is opening its arms to China and China is reciprocating." Recently, there has been a notable increase in the volume of trade between China and Latin American nations, especially as China seeks Latin American foodstuffs, goods, and natural resources—such as Brazilian soybeans and Venezuelan oil.

China is promising the region a large amount of investment, but at the same time appears to be moving somewhat cautiously in the area so as to not alarm Washington. As the Commission heard at the hearing, the Chinese have moved judiciously to cultivate relations so as to not jeopardize long-term economic, diplomatic, and strategic goals in Latin America.

Northeast and Southeast Asia

China is attempting to become the dominant economic and military power in East Asia and, in doing so, as Daniel Blumenthal told the Commission, "displace the United States as the pre-eminent power" in the region. To achieve such status, China is using its economic growth, trade relations, military buildup, and political ties as sources of leverage with its neighbors.

The Taiwan issue remains China's most immediate regional concern and the first half of this year saw Beijing take steps that appeared to follow an increasingly hard line on this topic, as illustrated by the passage of its Anti-Secession Law and by its ongoing military buildup. This situation is further complicated for the United States by the fact that Taiwan appears not to be sufficiently concerned about the Chinese threat, and has failed to acquire some weapons systems and other materiel that military experts believe it needs to shore up its defensive capability. According to Randall Schriver, "the [China-Taiwan] problem is getting a little more difficult because of hard-line attitudes in Beijing, accompanied by the [People's Liberation Army's] military buildup."

The United States, with its substantial naval presence and long-time influence in the region, poses an obstacle to some of China's regional objectives. Since China is unlikely to challenge the U.S. militarily, at least in the short-term, it is employing regional and economic diplomacy aimed at weakening Washington's ties and alliances in the area. China has formulated a strategy and is seeking to implement it. As a result, as one witness explained to the Com-

mission, “[t]here is a new great game underway . . . [and the United States] is distracted, focused elsewhere, hardly aware that the game has even started.” In fact, this is true for Washington’s response to China’s entire global approach.

South Asia and the Former Soviet States

To China’s immediate south and north are three nuclear-armed countries (India, Pakistan, and Russia), with two of which China has had violent border disputes in the last forty-five years (India and Russia). To the west lie the oil-rich nations of Central Asia.

As China’s search for energy resources expands and tensions with Russia and India subside, at least in the short-term, the United States must pay particular attention to China’s intentions toward South Asian nations and nations of the former Soviet Union.

As one expert testified, China is attempting to nurture improved ties with India—which traditionally has served as a regional counterweight to China. Chinese trade with India shows promise and China likely seeks access to Indian technology, especially in the computer software field. Strategically China seeks to assuage Indian fears of China’s growing relations with other nations in South Asia and wants to facilitate better relations with India so that India does not continue its trend of expanded cooperation with the United States, which China may perceive as threatening.

China’s relations with Russia also are changing. There is closer cooperation between the two nations in fields such as promoting regional stability and combating terrorism. In August the two countries conducted joint military exercises. China and Russia also are cooperating as the dominant countries in the Shanghai Cooperation Organization (SCO), a recently-established regional multilateral block that appears to have as one of its primary objectives reducing U.S. power and influence in the region. The SCO has called on the United States to set a deadline for withdrawing its troops from Central Asia.

On the other hand, problems may arise as a declining Russia seeks to retain its past prestige and regional control, particularly in Central Asia, and an ascending China seeks to assert itself in geographical areas and with respect to issues typically dominated by Moscow. As Professor Paul Goble explained to the Commission, neither nation is likely to be willing to play junior partner to the other.

One area for potential conflict is Central Asia, composed of a number of former Soviet states that are rich in energy resources. Currently, both China and Russia are cooperating in the region and share the objective of reducing U.S. influence in the area. But such cooperation could diminish as Russia aims to preserve its historical regional dominance in the face of increasing Chinese engagement with countries such as Uzbekistan and Kazakhstan.

Recommendations

Based on the information presented to the Commission about China’s growing global presence and its energy policy, we present four recommendations to the Congress for its consideration. We note for your information that, between the date of the hearing

about which this letter reports and the date this letter is being delivered, the Commission has completed and issued its 2005 Annual Report to Congress. In its Chapter 4, that Report summarizes the material provided above and also includes these recommendations.

1. The Commission recommends that Congress work with the Administration to assess China's objectives and tactics in regions around the globe and identify the extent to which Chinese interests run, or could run, contrary to U.S. interests. Specific areas and issues about which the Commission is concerned include China's efforts to:
 - Secure energy resources in the Western Hemisphere, which may lead the United States to depend more heavily on Middle East oil.
 - Improve its relations with, and obtain access to the oil and minerals of, problematic countries such as Iran, Sudan, and Zimbabwe that frustrate U.S. and other nations' efforts to curb the objectionable behavior of such countries.
 - Push U.S. counterterrorism forces in Central Asia out of the region.
 - Improve its rapport with India at the expense of the strengthening relationship between the U.S. and India.

To facilitate this effort, Congress should urge the Administration to increase intelligence capabilities focused on China and its global activities to increase U.S. knowledge about China's objectives and tactics.

2. The Congress should urge the Administration to reach out to and work with regional alliances, institutions, and organizations to preserve other sources of power and influence that can help to maintain political and power equilibrium in the world's various regions that may be adversely affected and distorted by a rising China.
3. The Commission recommends that Congress:
 - Mandate the establishment of a "U.S.-China Energy Working Group" in which both nations are represented by senior government officials, supported by an advisory group composed of representatives of relevant industry, environmental, academic, research and non-governmental organizations, and Members of Congress. The Group should have the responsibility to (a) identify areas where both nations can most profitably work together for mutual benefit on energy issues and challenges; (b) identify and rank areas and issues with respect to which there is a significant possibility that U.S.-China energy-related conflicts will develop; (c) offer recommendations to both governments for resolving energy-related problems and disagreements; (d) offer recommendations to both governments for promoting development and use of conservation and efficiency mechanisms, alternative fuels, and other means of securing energy self-sufficiency and reducing the need for imported energy sources, especially oil; and (e) oversee and make recommendations to both governments concerning joint research and development activities in energy-related fields;

- Encourage the initiation of new cooperative efforts with China to (a) increase the efficiency of its energy use, including energy use intensity reduction, clean coal technologies, coal-to-liquids technologies, and combustion efficiency improvements; (b) shift some current reliance on oil to coal (using advanced clean coal technology) and natural gas; and (c) explore and pursue the economic, technical, and logistical feasibility of using renewable energy sources in lieu of some portion of the projected increase in oil use. At the same time, China should be strongly encouraged to (i) abandon its policy of acquiring oil at the wellhead or field in a mercantilist fashion; (ii) procure oil and gas according to international practices (i.e. purchasing it on the open international marketplace); and (iii) cease providing assistance, arms, and proliferation-related technologies to problematic states in possible return for access to their energy resources; and
 - Urge the Administration to use all available bilateral and multilateral diplomatic means to persuade China to change its approach to energy security with respect to oil resources by (a) purchasing oil for import in the open international oil market; (b) coordinating its activities with the IEA; and (c) engaging in the IEA's efforts to build oil stocks and release them on a coordinated basis in the event of supply disruptions or speculation-driven price spikes.
4. The Commission urges Congress to instruct the U.S. intelligence community to increase its intelligence collection with respect to Chinese activities in Africa, Central Asia, and, especially, the Western Hemisphere, in order to advise both appropriate executive branch and legislative branch officials of energy-related actions and trends that warrant careful attention and response.

Thank you for your consideration of this report on the Commission's hearing and the resulting recommendations the Commission is making to the Congress. We note that the full transcript of the hearing plus the prepared statements and supporting documents submitted by the witnesses can be found on the Commission's Web site at www.uscc.gov, and that these can be searched by computer for particular words or terms. We hope these materials will be helpful as the Congress continues its assessment of China's growing global activities and influence, its role in world energy markets, and the steps the United States should pursue in response.

Sincerely,



C. Richard D'Amato
Chairman



Roger W. Robinson, Jr.
Vice Chairman

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CHINA'S GROWING GLOBAL INFLUENCE: OBJECTIVES AND STRATEGIES

THURSDAY, JULY 21, 2005

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION,
Washington, D.C.

The Commission met in Room 124, Dirksen Senate Office Building, Washington, D.C. at 8:55 a.m., Chairman C. Richard D'Amato, Vice Chairman Roger W. Robinson, Jr., and Commissioners Carolyn Bartholomew, June Teufel Dreyer and Michael R. Wessel (Hearing Cochairs), presiding.

OPENING STATEMENT OF CHAIRMAN C. RICHARD D'AMATO

Chairman D'AMATO. The Commission will come to order. We're very, very pleased this morning to have with us Senator Russell Feingold from the state of Wisconsin, now in his third term in the United States Senate. He serves on the Judiciary Committee, but more importantly for us, on the Foreign Relations Committee, is the Ranking Member on the Subcommittee of African Affairs, and a Member of the Subcommittee on East Asian and Pacific Affairs.

You might be interested, Senator, we're having a panel later today on Chinese strategies toward Africa with Ambassador Princeton Lyman and some others. We'll be glad to get that testimony to you when we get it.

Senator Feingold is known as an indefatigable fighter, takes the long view and a bipartisan way on major issues that confront the country. We're very, very happy to have you this morning. Senator.

[The statement follows:]

Prepared Statement of Chairman C. Richard D'Amato

Good morning and welcome to the U.S.-China Economic and Security Review Commission's hearing on *China's Growing Global Influence: Objectives and Strategies*. This hearing is being cochaired by Commissioners Carolyn Bartholomew, June Teufel Dreyer, and Michael Wessel.

China's influence—diplomatic, economic, and military—is growing on nearly every continent. China's quest for energy and commodities is a central reason for that country's increasing activities and presence around the globe, and a part of this Commission's mandate is to assess how China's growing economy is affecting the world's energy supplies and demand driven behavior. Over the next two days we will be discussing what is driving China's approach to various regions and the tools it is using to reach its goals. We will also be looking at how Beijing approaches discrete regions, including Asia, Africa, and Latin America, and how this activity may affect the United States and our interests.

China's industrialization, and the increasing income among some sectors of the Chinese population that is fueled by industrialization, has been producing a dramatic increase in demand for raw materials, energy, and consumer goods. The rapid increase in energy requirements has led China to establish and strengthen relationships with oil-producing countries in the Middle East, Africa, and even our own

“backyard” with countries such as Canada and Venezuela. We need to evaluate China’s energy strategy and its implications for U.S. national security. This is, of course, the central question in the matter of CNOOC’s attempted acquisition of Unocal.

The search for such resources is also leading China to ally itself with countries such as Sudan and Iran—that are of concern to the United States because of their poor human rights records, repressive and undemocratic governments, and contributions to regional instability and conflict—in return for long-term oil contracts. Beijing’s diplomatic, economic, and/or military support for these nations frustrates American efforts, and efforts of other nations and international organizations, to obtain responsible changes and improvements in their behavior.

It is imperative for Washington to understand China’s global objectives, the resulting implications for the U.S., and how, as a nation, we should respond. In particular, it is vital for Congress to make knowledgeable, informed decisions. Our purpose here is to collect and help Congress evaluate the information it needs in this respect.

I’ll now turn the microphone over to the Commission’s Vice Chairman, Mr. Roger Robinson.

PANEL I: CONGRESSIONAL PERSPECTIVES

STATEMENT OF RUSSELL D. FEINGOLD A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator FEINGOLD. Thank you, Mr. Chairman, and thanks to all the Members of the Commission. I really do wish I could stay and hear what your proceedings are today. I can’t think of a topic that’s much more important than this, and I particularly would like a copy of the proceedings concerning Africa.

Chairman D’AMATO. Certainly.

Senator FEINGOLD. Thank you not only for this opportunity to speak but also for your courtesies to allow me to speak at this time because there are so many other things happening this morning.

I am pleased to speak on my perspective on one aspect of China’s growing global influence. As you’ve alluded to, I’ve served on the Senate Foreign Relation Committee Subcommittee on African Affairs for over 12 years. I have traveled widely in North and sub-Saharan Africa in recent years. I’ve been struck by the energized campaign of engagement in the region that is being pursued by the People’s Republic of China.

There are many issues on which I favor a tough U.S. policy response to China: certainly when it comes to proliferation, when it comes to the dismal Chinese human rights record, and of course, when it comes to unfair trade practices. But not every Chinese policy and initiative is a threat and our interests are not always destined to conflict.

When it comes to China’s engagement in Africa, careful analysis and levelheaded policy responses are required. This engagement is not a bad thing in and of itself, but we should be asking ourselves what it tells us about Chinese grand strategy and what that means for our own.

The evidence of Chinese engagement is strikingly apparent as it is often tangible: new roads, new buildings, housing, government ministries, and of course the almost ubiquitous Chinese-built soccer stadiums. But not all of it is apparent from a windshield tour.

China’s loan to Angola last year relieved the government in Luanda of the pressure they felt to come to an agreement with the IMF, an agreement that would have come with strings attached, limiting the Angola’s government capacity to continue siphoning off

state resources for personal gain in this appallingly underdeveloped country.

China's investments in Zimbabwe have not just helped the oppressive regime of Robert Mugabe financially. They've helped him politically, as he tells his starving population not to worry, China will replace whatever support has been lost in the West as a result of the ruling party's utter disregard for the rule of law.

In Sudan, Chinese oil investments have helped to prop up a regime in Khartoum that our President and this Congress have accused of involvement in genocide in Darfur. It came as no surprise that China was reluctant to acquiesce to meaningful Security Council action to address this crisis.

According to some reports, nearly 700 Chinese companies operate in 49 African countries and trade between China and the continent has been flourishing, making China one of the continent's top trading partners.

The Chinese seek influence, markets, access to raw materials and most critically energy to fuel their growing economy. It's clear that they see Africa as a fertile facilitating ground to help them secure their own economic gains, and in doing so attain a new level of global power.

Some would respond to this Chinese agenda with alarm, a sense that the United States is losing while China gains and a resolve to redouble American engagement efforts in the region. But a note of caution is in order here. The United States must not fall into the trap of believing that simply because China is willing to provide some package of assistance, enter into some partnership or make some investment, that the United States should always be trying to beat the Chinese to the punch.

Training and equipping abusive military services with no strings attached on the grounds that if we don't, the Chinese will, is a self-defeating strategy. Propping up violent authoritarian regimes for fear of losing some perceived power struggle to Beijing would not only be shameful, ultimately it would be unwise and a bad investment for the American people.

Abandoning our standards means losing some of our unique power, our power to lend legitimacy to a given enterprise and our power to lead, to persuade and to inspire. Loss of this power is loss of leverage, and if we head down this dangerous road, we find ourselves with less influence in the developing world rather than more influence.

This point holds for the American government and it should be front and center as we make decisions about what the United States does with the resources of American taxpayers and in the name of our great democracy.

It should also hold for the private sector and corporate responsibility should not be sacrificed in the name of a real or imagined competition with China. Just as our policies and principles are more than niceties in government—they are at the very foundation of what it is we hope to achieve in the world—so too should basic tenets of corporate responsibility be more than window dressing for the business community.

Members of that community can serve as vitally important guardians and guides, protecting investments and pointing the way

toward sound and stable growth and away from seemingly attractive prospects that are ultimately revealed to be counterproductive.

Let me conclude by simply observing that newly energized Chinese engagement in Africa deserves close attention, but if we refuse to abandon who we are and what we stand for, it could ultimately be a positive thing for the United States. There may well be some areas in which the United States and China can collaborate constructively, working in partnership with each other and with Africans to bring stability to very unstable places, to promote development and to improve the prospects of communities that are full of potential.

Over time, China may decide that its investments would be far safer in a context of stability and good governance, and may come to share some of our policy goals. Principled cooperation can be good for our bilateral relationship with China, and also good for Africa. I say this not out of naiveté about China's intentions, but I hope based on a hard-headed analysis of Chinese and U.S. interests in the region.

Moreover, China's engagement strategy serves to remind the United States that others see the strategic significance of a part of the world too often ignored in the United States, and we should learn from that. This is not a call, of course, to repeat the mistakes of the Cold War when Africa was too often treated as some kind of geopolitical chessboard, but it is a call for recognizing that in the vast and remarkably diverse continent of Africa, critically important future partners, markets and leaders are emerging. If China's attention to this obvious reality helps to prod the United States into more and better engagement done on our own terms, so much the better.

Thank you for this opportunity and thank you for the work that the Commission is doing.

Chairman D'AMATO. Thank you very much, Senator Feingold. Just one comment is that we've had some indications that the Chinese put top priority on Africa as opposed to many other regions of the world and probably for some of the reasons that you mentioned: we're not involved there; it's easy for them to be involved; and it's a tremendously rich continent.

If you have one moment, I think the Vice Chairman wanted to make a comment about your mention of corporate responsibility.

Vice Chairman ROBINSON. Senator, thank you very much for your remarks. I think it's not often that you hear the corporate or private sector addressed in this context. I think it's terribly important that you've laid out a kind of program for security minded and human rights sensitive corporate governance.

After all, corporate governance is a very big topic these days and yet we find publicly traded companies oftentimes quite calloused in the way they provide life support of all forms, revenues, advanced equipment and technology, expertise, even political cover for oppressive regimes like that in Khartoum and elsewhere. I very much hope that your Senate colleagues share your desire to ensure that the private sector and our corporate friends share this responsibility and understand the financial point as well, which is it's better for their shareholders to incorporate these sensitivities in their proceedings.

Thank you very much for that.

Senator FEINGOLD. I'll do everything I can to convey that to my colleagues.

Chairman D'AMATO. Thank you very much, Senator. We appreciate your coming this morning. We know you have a busy schedule. We'll take about a two-minute break. We're waiting for Senator Inhofe.

[Whereupon, a short break was taken.]

Chairman D'AMATO. The Commission is very, very happy to have Senator James Inhofe from Oklahoma with us this morning in his second term in the United States Senate, and previously serving a number of terms in the House of Representatives. In addition to chairing the Senate Committee on Environment and Public Works, Senator Inhofe is also a Member of the Senate Committee on Armed Services.

We are most appreciative of your support for the Commission, Senator Inhofe. And I know that Senator Inhofe has been very interested in looking at the CFIUS process and how the Congress can play a more constructive and responsible role in that process. We appreciate your coming this morning, Senator. Thank you.

**STATEMENT OF JAMES M. INHOFE
A U.S. SENATOR FROM THE STATE OF OKLAHOMA**

Senator INHOFE. Thank you very much. I appreciate that. Let me first of all thank all of you for the fine work that you've done. I think it has not been noticed by enough people, and it's something that when I had a copy of your report and your work, I got very enthusiastic about it, and that precipitated four much longer speeches than most people like to listen to on the Senate floor about China and about some of the problems that we have.

I gave four speeches over a period of I think one a week for four weeks. We found the recommendations of the Commission's report to be objective, necessary and urgent, and this morning, I'm introducing an amendment to the Defense Authorization bill—I'm the second Ranking Member of the Senate Armed Service Committee—and I'm going to introduce an amendment to the Defense Authorization bill which is currently on the floor that conveys support for these recommendations. The amendment expresses the sense of the Senate, and these are the recommendations that have been in various reports that I'm using in the legislation. It does enjoy bipartisan support.

First of all China should reevaluate its manipulated currency level and allow it to float against the currencies, one of your recommendations. This probably is one that more people are aware of than you realize because people saw, all of a sudden, wait a minute, they have figured out a way that is to their economic advantage to have these negotiations and that's something that can't happen.

The second thing that's in the amendment is that appropriate steps ought to be taken through the World Trade Organization to hold China accountable for its various trade practices that we have found to be somewhat dubious.

The third, the U.S. should revitalize engagement in the Asian region by broadening our interaction in organizations like the Asso-

ciation of Southeast Asian Nations. Our lack of influence in that area was demonstrated when the Shanghai Cooperation Organization recently demanded that we set a troop pullout date for Afghanistan.

The next one is that China should be held accountable for the proliferation of prohibited technologies. Chinese companies like NORINCO have been sanctioned frequently, and yet the Chinese government refuses to enforce their own nonproliferation agreements. They just keep on doing it just as if those agreements are not in place.

The next one is the U.N. should monitor nuclear, biological and chemical treaties and either enforce these agreements or report them to the Security Council. The U.S.-China Commission has found that China has undercut the U.N. in many ways, undermining what pressure we've tried to apply on problematic states such as Sudan and Zimbabwe, both are places that I have been to, and have seen those problems.

Then the various energy agencies should encourage China to develop a strategic oil reserve, which comes to the next one, which has been a great concern for me. I've had occasion to spend quite a bit of time in sub-Saharan Africa. I find everywhere I go, any country down there that has any kind of oil activity, any kind of reserves, the Chinese are building things. I'm talking about coliseums and roads and bridges and they say, the United States tells us what we ought to have, and then the Chinese give it to us.

This is not out of the generosity of their hearts. We see that one of the serious problems that's coming up is that we have become reliant upon foreign sources for our ability to fight a war in this country. I became interested in this back during the Reagan Administration. I thought surely when the first Bush Administration came along, that we would do something about our dependency on foreign countries.

He didn't do it. And finally this President is. But right now we're at 65 percent reliance on our ability to fight a war. It's a very serious thing. We know what the Chinese are doing things with Chavez down in Venezuela and these other countries, and I think that poses a very serious threat to this country and we've got to do something about it now, and you have certainly addressed this in your recommendations.

Penalties should be placed on foreign contractors who sell sensitive military technology or weapon systems to China benefiting from the U.S. defense related research. In other words, they're taking some of the things that we put together, the research and using that technology in China.

Now, as leading step addressing these problems with China, I'm also introducing a second amendment today to the Defense Authorization bill. This amendment addresses the review process of foreign acquisitions in the United States presently reviewed under the control of such as the activities of CFIUS. It's been interesting that this operation, this CFIUS, out of 1,500 cases on foreign investments or acquisitions, only 24 have been reviewed, and of those only one was rejected, and that was because I put some pressure on them and it didn't—well, that is not right.

I'm going to be specific, and one of your recommendations is we should at least look at the make-up of this committee. We look at the seriousness of the proposed acquisition of Unocal Corporation, a huge oil corporation that has control of the only mining of the precious mineral that is used on smart bombs. It's a very serious national defense problem. I was pleased to find out this morning that Chevron yesterday increased their offer and hopefully that might change the dynamics a little bit.

So let me just say in summary, I've become concerned about this for a long period of time. During the 1990s, during the Clinton Administration, we had somewhat of a drawdown in our defense capabilities. This mentality a lot of people have is the Cold War is over, we don't need a military anymore. That was alive and well in the 1990s. It cut our force strength down by about 40 percent. The modernization program went sideways.

I was very proud of John Jumper—at that time, he was not in the position he's in today—he wasn't Chief of the Air Force, but he was a general, and he had the courage to stand up in 1997 and admit to the people of America that now other countries are making better equipment in the battlefield than we have.

He specifically talked about the Russians having the SU30 series, which is a better strike vehicle than either our F15 or F16s. Now when the F22 and the Joint Strike Fighter come on line, then we'll correct that situation. In the meantime, China in one purchase that I recall at that time, and I'm sure it's been a lot more since then, purchased some 240 of these vehicles. So it's not just a matter of having a threat that has concerned me of the nuclear build up, but also the conventional capability that they have developed.

That was my initial interest and when I saw your reports and the fine work that you've done, I thought I've got to piggyback on that, pass some legislation and try to correct this problem, and that's what we intend to do.

Thank you, Mr. Chairman.

[The statement follows:]

**Prepared Statement of James M. Inhofe
A U.S. Senator from the State of Oklahoma**

Thank you for inviting me today. I have been closely following the growth of China, and have found the U.S.-China Commission's reports and hearings very insightful. I applaud your effort to provide Congress with a clear picture of a very difficult situation; your work is illuminating and challenges us to face these very real and growing problems.

Over the past few months I have given four floor speeches on China's growing global influence and the impact this has on our national security. These issues cover a broad spectrum, from an alarming military modernization to the lack of economic accountability.

I have found the recommendations in the Commission's 2004 Report objective, necessary, and urgent, and I am introducing an amendment to the Defense Authorization Bill—which is currently on the floor—that conveys support for these recommendations. This amendment expresses the sense of the Senate that:

- China should reevaluate its manipulated currency level and allow it to float against other currencies. In the Treasury Department's recent Report to Congress, China's monetary policies are described as "highly distortionary and pose a risk to China's economy, its trading partners, and global economic growth."
- Appropriate steps ought to be taken through the World Trade Organization to hold China accountable for its dubious trade practices. Major problem issues such as intellectual property rights have yet to be addressed.

- The U.S. should revitalize engagement in the Asian region, broadening our interaction with organizations like ASEAN. Our lack of influence has been demonstrated by the Shanghai Cooperation Organization recently demanding that we set a troop pullout deadline in Afghanistan.
- The Administration ought to hold China accountable for proliferating prohibited technologies. Chinese companies such as NORINCO or CPMIEC have been sanctioned frequently and yet the Chinese government refuses to enforce their own nonproliferation agreements.
- The U.N. should monitor nuclear/biological/chemical treaties and either enforce these agreements or report them to the Security Council. The U.S.-China Commission has found that China has undercut the U.N. in many areas, undermining what pressure we've tried to apply on problematic states such as Sudan or Zimbabwe.
- The Administration ought to review the effectiveness of the "One China" policy in relation to Taiwan to reflect the dynamic nature of the situation. The Defense Department's annual Report to Congress, released two days ago, states that China's military's "sustained buildup affects the status quo in the Taiwan Strait."
- Various energy agencies should encourage China to develop a strategic oil reserve in order to avoid a disastrous economic crisis if oil availability becomes unstable.
- The Administration should develop and publish a national strategy to maintain U.S. scientific and technological leadership in regards to China's rapid growth in these fields.
- The Committee on Foreign Investment in the United States (CFIUS) should include national economic security as a criterion for evaluation and the chairmanship to be transferred to a more appropriate chair, allowing for increased security precautions.
- The Administration should continue in its pressure on the EU to maintain its arms embargo on China. The recent Defense Department report states that the EU would not have the capability to monitor and enforce any limits if the arms embargo is lifted.
- Penalties should be placed on foreign contractors who sell sensitive military use technology or weapons systems to China from benefiting from U.S. defense-related research, development and production programs. The Administration should also provide a report to Congress on the scope of foreign military sales to China.
- And finally, we should support the recommendations of the Commission's 2004 Report to Congress.

As a leading and appropriate step toward addressing these problems with China, I am also introducing another amendment on the Defense Authorization Bill. This amendment addresses the review process of foreign acquisitions in the U.S. Presently the review of controversial buys, such as the CNOOC, currently falls to the Committee on Foreign Investment in the United States (CFIUS). I will state this simply: CFIUS has not demonstrated an appropriate conception of U.S. national security. I understand that Representatives Hyde, Hunter and Manzullo expressed similar views in a January letter to Treasury Secretary John Snow, the Chairman of CFIUS. Of more than 1,500 cases of foreign investments or acquisitions in the U.S., CFIUS has investigated only 24. And only one resulted in actually stopping the transaction. This lone disapproval, in February 1990, occurred with respect to a transaction that had already taken place—it took President George H. Bush to stop the deal.

China's energy expansion has recently been brought to light through the current \$18.5 billion bid by China National Offshore Oil Company (CNOOC) to acquire Unocal Corporation, a U.S.-owned energy company. This situation is ironically similar to when China sought to acquire Russian oil companies in 2002. However, faced with this buyout, the Russian legislature forced Sinopec, China's state-owned oil company, to withdrawal from the bidding on Slavnet, Russia's ninth largest oil company. The Russians feared that they would lose economic control of their Far East region.

I have outlined in my earlier speeches how China is a threat. I believe it is. But this is a threat that can be addressed and enable a healthy, mutual growth for both our countries. A primary step toward this end is addressing the shortcomings of the CFIUS review process. This second amendment is a step in that direction.

First, it clearly charges the Commission with measuring energy and economic security as fundamental aspects of national security.

Second, it brings congressional oversight into the foreign investment review process. After a 10-day review period, an oversight committee chairman can extend the review period to 30 days. Congress then has the option to pass a resolution of disapproval and thus stop an acquisition harmful to our country.

Third, the amendment calls for a report on the security implications of transactions on a monthly basis. There will also be a yearly report to the proper congressional committees that will review the cumulative effect of our sales with China.

The amendment also changes the actual name of the review mechanism to reflect the national security focus that it should be emphasizing. The new name would be Committee on Foreign Acquisitions Affecting National Security, or CFAANS. For those same reasons, the Secretary of Defense would be designated as Chairman of CFAANS.

The foreign investment review process is a vital part of providing for U.S. security, particularly in relation to countries such as China. I think that it is clear we can improve the process and enable it to better perform its authorized purpose.

The U.S.-China Economic and Security Review Commission was created to give us in Congress a clear picture about what is going on—and you have done your job well. Now we in Congress must do ours. Thank you.

Chairman D'AMATO. Thank you very much, Senator Inhofe, and let me say I speak for the entire Commission in expressing our appreciation for your help and your work in this area. We hope you get a good reaction and particularly on the CFIUS amendment. Our feeling is the CFIUS process has been broken, as you mentioned, and has not defended the national security as it should have in the way it was set up to do.

We think the attempt by CNOOC to acquire Unocal is a national security matter and should be rejected. We don't think CFIUS necessarily will be the spear in that attack. We hope they would be.

Senator INHOFE. Not judging from their past performance.

Chairman D'AMATO. So we would certainly think the Congress might want to step in at some point or another and just say no.

Senator INHOFE. Mr. Chairman, I might add there is one problem in that hopefully we can correct. I did call Senator Shelby this morning, Chairman of the Banking Committee. They may think there's a jurisdictional problem that this should be on bank legislation as opposed to—I don't look at it that way. I look at it as a national security issue, but I'm going to try to win that one this morning.

Chairman D'AMATO. Well, good luck on that. We wish you luck on that, Senator, and thank you very much for coming by.

Senator INHOFE. Thank you.

Chairman D'AMATO. We appreciate your work.

Senator INHOFE. Thank you very much for your work.

Chairman D'AMATO. Thank you. I think Congressman Randy Forbes is here. Why don't you come on up to the table. Congressman Forbes is one of the Cochairmen of the Congressional China Caucus, and let me just say that's been lonely out there for awhile, and we certainly appreciate the company and look forward to working with you and your staff and the excellent bipartisan group of Members that you have on your group. We appreciate your coming and look forward to your comments.

**STATEMENT OF J. RANDY FORBES
A U.S. CONGRESSMAN FROM THE STATE OF VIRGINIA**

Congressman FORBES. Well, thank you, Mr. Chairman, and hopefully some help is on the way from the House side. Let me first of all thank you for the great work that you're doing. I want to echo

what the Senator said. I really don't know that when our children write about what we are doing in the next several decades ahead, whether they're going to write that China became our great friend or perhaps a dangerous enemy, but one of the things that I know is the work that you're doing is going to help to encourage the former and hopefully be prepared for the latter.

Thank you for allowing me to have a few moments to speak with you today and to tell you for years, we have had business leaders that have talked to us about the tremendous opportunities that we have in China. It doesn't take a rocket scientist to determine if you've got 1.3 billion people, that's a great market to sell products to.

In addition to that, it's great to get cheap goods that we can come over here and we can sell from cheap labor in China. However, our foreign policy eyes tend to have been focused in a major part on Iraq, Iran and North Korea and the war on terrorism and yet today when you look around, it's almost impossible to look anywhere in the world and not see the enormous influence of China.

One of the things that I equate to, many of you may remember the movie *Jaws* that came out about 30 years ago. In the movie there's a great scene—I think the guy's name was Brodie—and he was in the back minding his business, having a conversation, looking at the bow of the boat, throwing bait over in the water, and all of a sudden to the shock of him and everybody in the audience, this huge giant shark comes out of the water and scares everybody in the audience including him.

That's pretty much where China is today. We have all been doing all the things we need to do and all of a sudden, it has emerged with that kind of force on the world scene with the presence and really a concern that I think shocks many of us.

In January, I led one of the largest delegations to China that we've had go over there. It's with the blessing of the Chairman of the Armed Services Committee, Duncan Hunter, and it was a delegation that the Ranking Democrat in the Armed Services Committee, Ike Skelton, and I led to China, and let me tell you, if I had to summarize our expression when we got back in the plane after days, it would have been "uh-oh," as we looked in there.

I think some of the conclusions we had and certainly not all of them, but were these. One of the big things is that China knows a lot more about us than we know about them. They speak our language. We have few people that speak their language. They know the districts that we represent. They know the people in our government and we don't know nearly as much about them, and that's a significant liability.

Secondly, they have a shipbuilding plan, unlike us. If you've looked at what they've done, they can put a ship from concept to launch in six months. Most of their shipyards have four at a time going right now, and they're doing it very methodologically and very intelligently; they're bringing their resources to where their shipbuilding is taking place. We oftentimes think they're just looking at cheap labor. That's not true.

They're looking at efficient ways to get more out of their labor. Their steel plants are putting out sheets of steel the way we used

to do chocolate kisses, and they're doing them 24 hours a day in a very effective manner.

We've seen what they've done with the increase they have in their auto sales, and when you align that with the buildup of their navy, their demand for fuel and other raw materials, it's just becoming enormous.

While I was there, they talked about buying a billion dollars' worth of coal from Virginia and West Virginia alone, and they produce more coal than any country in the world. That's just the kind of appetite they're looking at.

We all know the great theft we've seen with intellectual property rights. There are two big things—it puts our business people at a huge disadvantage, but it also gives them a great advantage in world markets that we've got to look at. They've developed a strategy, which is orchestrated and well thought out of really getting our U.S. technology and our military information that we have just got to address and we have got to look at.

Finally, two things. If you've looked at what they've done with the modernization of their military, it is absolutely concerning because, as you know, for every dollar we see because of their lack of transparency, there's probably three or four times more than that that's actually being spent.

They've had very little movement in their human rights over the last several years. So we're not making huge headway in that front. And the final thing I'll tell you that all of us concluded from talking to their military leaders that probably the most dangerous place in the world right now is the Taiwan Strait. That is an absolutely frightening scenario for us if we make a wrong step there.

When we came back, we were giving a number of talks, and speeches places, and several Members of Congress came to us and said you need to form a caucus so that you can give this information out to Members, and I'll tell you, I hate to admit it, but I was shocked that we didn't have a China caucus already as big as this issue is and it wasn't, and as we dug into it, we found not only did we not have a caucus, we didn't have a major committee or subcommittee that had a designation to really look into China.

So we came together and we formed a bipartisan caucus with Ike Skelton and me. If you look at the people on the caucus, they are across the spectrum which I think gives us enormous credibility. So when people look at that caucus, it's not anti-China, it's not pro-China, but it's at least a clearinghouse for information so we can analyze some of the problems and at least ask the right questions, so that we can perhaps get that information disseminated to Members, and our goal was to be a catalyst either through jealousy or competition or whatever it took to create more entities like that, and it's worked.

One of the things that we have seen in the House already, as you know, is we've had a number of different hearings over the last two weeks in the House. We think that that will continue as we move forward.

Two big resolutions—you're familiar with both of them—but House Resolution 57, for example, about the arms embargo. Many times our resolutions get passed, they go in a trashcan, and nobody really cares. That was a big resolution. When I was meeting with

the Europeans to talk to them about not lifting the arms embargo, many of them really didn't believe that that was a big issue to us, and when you can pull out that resolution and say it passed 411 to 3, you could see that that made a difference in many of those parliamentarians' minds.

The second thing, of course, is we had House Resolution 344 on the Unocal issue that you talked about earlier, and I think the overwhelming vote, 398 to 15, shows that the House Members are at least moving in this direction.

Over the past two weeks alone, there have been five committee hearings on China in the House, more scheduled for July and September. Our caucus has taken the approach that every month, we have divided into areas of expertise, somebody on shipbuilding, some on human rights, some on ideology, so that we can come together in a working group with the best minds that we can bring together in the country and say how we can analyze these problems and get the information out to Members of Congress.

The final thing I want to tell you this morning, if I could suggest two major worries that we have from every briefing that we've attended and all of the information we have attained, it would be these:

One is that we just have a huge void about knowledge of China. We can be in briefing after briefing—I know you've experienced the same thing—ten people briefing us and we ask them always, who speaks Chinese in here, none of them at that particular point in time, and yet we look at reports of their generals, their leaders. They can speak English very well. In fact, it's always comical when you're over there meeting with them; you have the formal talks, you have the translator there. Many times the person doing the talking will stop and tell the translator he didn't interpret it right, and he'll tell him in English what he should have been saying. So they have that information about us that we don't have about them.

The second thing, and this is the thing that bothers us most, in almost every briefing that we will attend, it always concludes with them thinking there's somebody higher up the food chain that has a plan of how we're going to deal with this whole China issue.

There's nobody up the food chain that they ever know about, and we talk to different agencies, and the other day I heard someone come back and said this is an interagency consensus, and I said that's impossible because every agency we talked to, they don't talk to each other, and the one thing that I would just suggest, if you can continue to work to getting us a governmental coordinated effort where agencies are sitting down because this is a multifaceted approach, that you can't pigeonhole it and say this is Defense, this is State, this is Commerce, it interrelates in a very complex fashion, and we need a clearinghouse to sit together and do that.

So with that, let me thank you for allowing me to be here. Thank you for your work and to tell you that we look forward to working with you and other Members of Congress to help make sure we're prepared for this great issue that's coming forward.

[The statement follows:]

**Prepared Statement of J. Randy Forbes
A U.S. Congressman from the State of Virginia**

Chairman D'Amato, Vice Chairman Robinson and distinguished Commissioners, first let me thank you for the work you are doing on this Commission. I do not know whether our children will one day write that China became our great friend or a dangerous enemy, but the work you are doing will help us encourage the former and be prepared for the latter. Secondly, let me thank you for allowing me to testify today. For years we have heard about the tremendous opportunities available in China. Our business leaders have understandably salivated at the thought of a market comprised of 1.3 billion people and of the ability to offer inexpensive goods to Americans that were made by cheap labor in China. Our foreign policy eyes have been focused on Iraq, Iran, North Korea and an international war on terrorism. However, recently it has become almost impossible to look anywhere in the world and not see the influence of China.

Many years ago I remember watching a movie titled "JAWS." In that movie there was a famous scene in which the local sheriff was facing toward the bow of the boat while he went about his business of tossing bait into the water behind him. He was carrying on a normal conversation when suddenly almost out of nowhere this giant shark emerged from the water at the stern of the boat and shocked both the sheriff and everyone in the audience. That is exactly what China has done to most of the world. It has emerged seemingly out of nowhere and splashed upon the world with frightening speed and presence.

In January of this year I led a delegation of Members of Congress to China. It was one of the largest delegations to visit China in years and I was joined by the Ranking Member of the House Armed Service Committee, Congressman Ike Skelton from Missouri. Our observations and conclusions were unanimous:

1. China knows far more about us than we know about them. Our lack of knowledge is a significant liability.
2. Unlike us, they have a shipbuilding plan and they are implementing that plan. They can produce a commercial ship in just six months from concept to launch and in just one of their yards they are producing them four at a time. They are intelligently and methodically relocating their materials near the shipyards including their steel plants and they are making them more and more efficient.
3. Their steel plants are modern and efficient and they seem to be producing sheets of steel as fast as we used to produce chocolate kisses; twenty-four hours each day.
4. Their auto sales are increasing at almost fifty percent per year and if you align this with the increase in their naval vessels the Chinese demand for fuel will continue to increase geometrically.
5. They are ignoring intellectual property rights whether its software design, DVDs, autos, or electronic components the effect of which is to steal millions of dollars from the Americans who lawfully own those rights and to create an unfair trade advantage over citizens in the U.S. who are paying for those rights to produce products or deliver services here. While this certainly does not account for our 162 billion dollar trade deficit it does impact it significantly and it gives Chinese businesses an unfair trade advantage around the world.
6. They have a large and well-developed strategy to obtain U.S. technology and their access to sensitive dual-use and military technology has eroded the U.S. military advantage, degraded the U.S. Intelligence Community's ability to provide information to policymakers and undercut U.S. industry.
7. They have an enormous appetite for raw materials including coal, oil, and scrap metal.
8. They are modernizing their military at a significant rate and their lack of transparency should concern us. They have no significant enemies threatening their borders so the U.S. seems to be the target for their new weapons.
9. Only a few years ago they were trying to buy weapons with credit. Today they are modernizing their military with our cash.
10. When we hear of large sales of U.S. products to China, we must look beneath the surface and ask what percentage of these goods is made in the U.S. and whether we will have contracts for replacement parts or service.
11. There has been almost no movement in the area of human rights and religious freedoms in China.
12. Their lack of transparency can lull us into a false sense of technological superiority.
13. Their people are hard-working and there are tremendous opportunities that could be achieved between our two countries.

14. Their commitment towards Taiwan is serious and the most dangerous area in the world today could very well be the Taiwan Straits.

After I returned from China I began discussing what we had found and several Members of Congress asked me to form a caucus to better disseminate this information. I was actually astonished to discover that no caucus existed on a country as big as China. I was even more amazed to find that there was no congressional committee or subcommittee dedicated to China.

I then joined with Congressman Ike Skelton to form the Congressional China Caucus in May of this year. Our hope with this caucus was to be a clearinghouse for issues pertaining to China and to serve as a catalyst for the creation of additional organizations to study these issues.

The Congressional China Caucus was designed to create an in-depth analysis of China. It is neither, anti-China nor pro-China, however our role is to present the challenges posed by China as well as the opportunities. Our web site serves as a clearinghouse of information on China for Members, their staff and the public. It is a fully bipartisan caucus.

The Caucus also serves as a forum for Members of Congress who share a common interest in the emergence of China as a political, economic and military actor on both the regional and global stage. The Caucus membership has diverse areas of expertise and will be putting our Members to work. For example, Congresswoman JoAnn Davis will be taking the lead on shipbuilding, Congressman Thad McCotter will examine Chinese ideology, Congressman Phil English will focus on trade, Congressmen Jeff Miller and Steve Pearce will study human rights issues and Congressman Jim Cooper will examine economic trends. Each month, the Caucus meets to analyze and discuss issue areas pertaining to China with some of the best thinkers and writers in our country.

It has become more and more difficult to ignore China. In the past two months, China has been on the cover of *Newsweek*, *U.S. News and World Report*, *Time* and *Fortune*. Headlines in newspapers and periodicals from all over the world are screaming at us:

“Beijing Devoted to Weakening ‘Enemy’ U.S., Defector Says”

The Washington Times, June 27, 2005

“The China Challenge, Special Report: What the awakening giant will mean for America”

U.S. News and World Report, June 20, 2005

“Time to Act on Chinese Theft”

National Journal, May 14, 2005

“China’s Insatiable Appetite”

The Wall Street Journal, May 12, 2005

Congress is slowly turning its attention to this issue. The House recently passed two resolutions with respect to China, an indication that increased dialogue is critical to greater understanding and awareness of China’s reach.

H. Res. 57, a resolution urging the European Union to maintain its arms embargo on the People’s Republic of China passed the House by a vote of 411–3 on February 2, 2005. H. Res. 344, a resolution expressing the sense of the House of Representatives that the national security of the United States could be threatened or impaired by a Chinese state-owned energy company should it exercise control of critical United States energy infrastructure and energy production capacity, passed the House of Representatives by a vote of 398–15 on June 30, 2005. Our work will continue next week when the House is scheduled to vote on a package of measures aimed at cracking down on trade abuses by China.

I believe that this legislative activity is an indication of things to come. Over the past two weeks, at least 5 committee hearings have been held on issues pertaining to China, and many more are in the works for July and September. The Caucus itself will be holding a briefing on the DoD report on “The Military Power of the People’s Republic of China” next week and a joint briefing with the Shipbuilding Caucus in September to examine the status of China’s shipbuilding industry and their naval posture.

If I could summarize our greatest concerns at this time, they would be the following:

1. There is an enormous void in our knowledge of China which must be filled. We have few analysts who read or speak Chinese or fully understand their culture. On the contrary, many of their leaders including their generals speak English and many were educated in America.

2. At every briefing we attend, no matter how high ranking the participants, we are told that there is no coordinated approach to analyzing the multi-faceted complex nature of the China problem and the communication between agencies is inadequate at best. This must be remedied as soon as possible.

I look forward to working with the Commission and our colleagues in Congress as we analyze the opportunities and challenges presented by this rising power. Thank you for allowing me to be here this morning. I'd be happy to answer any questions you may have.

Panel I: Discussion, Questions and Answers

Chairman D'AMATO. Thank you very much, Congressman, and we appreciate your leadership on this issue. I don't think there is anything that you have said that any of us would take issue with at all. Certainly, the fact that knowledge—someone said knowledge is power, and they certainly do understand us and work hard to understand us a lot more than we do them, and that's our fault.

They're pretty tough cookies. We've worked on this currency thing for quite a long time, and it was just released this morning the information that they have revalued their currency in a sense to tag it to a basket of currencies and not the dollar. And that's going to go up about one cent on the yuan here. This is the "thousand-year program," I think, in terms of revaluing the yuan. So this is a bunch of tough cookies. I'm thinking of that shark and the currency thing.

Congressman FORBES. That's right.

Chairman D'AMATO. Again, thank you for coming and we really appreciate it very much. I don't know if anybody has any particular questions for the Congressman. Carolyn Bartholomew.

Cochair BARTHOLOMEW. Thanks, Mr. Chairman. Thank you, Congressman Forbes. I noticed in the list of participants of the caucus that Congressman Wolf is involved. Congressman Wolf and my former boss, Congresswoman Pelosi had the predecessor to the caucus. I'm really pleased to see that someone is taking up the charge and moving forward in a comprehensive bipartisan way.

I think one of the issues that the CNOOC deal raised was to my mind the question of who is in charge in the U.S. Government. I think you put your finger on a very important point, which is you mentioned the strategic vision that the Chinese government has in terms of shipbuilding.

We know that they have that strategic vision in terms of all sorts of industries, and we know that they have a strategic vision of what they are trying to accomplish and where they are trying to get. The U.S. Government response for 15, 16 years at least has, unfortunately been very ad hoc. When you speak to one negotiator who is over there talking about something, and you say, well, what is it that they want? You know they're going to do this, but what are going to get in exchange? If they're talking about IPR, what do they think they're going to get in currency? I've been astonished how many times people say, well, what we focus on is this piece of the pie. I think that it's critically important that you in Congress keep reminding the Administration that somebody needs to have a big picture vision of what's happening so we really look forward to working with you.

Congressman FORBES. Well, thank you for those comments. Congressman Wolf is actually the major driver. He grabbed me after

hearing me give a speech somewhere and he said you've got to do this. But the second thing is I don't even mind if they have considered all the facts and then ultimately say, no, this is where we want to set our priorities, but in talking with all of them, that's not happening because they don't know.

I really am concerned that if the State Department doesn't know what DoD is looking at, they can't operate effectively in doing that, so we have got to bring about a group that can sit down and look at it in a multifaceted nature. So thank you.

Chairman D'AMATO. Thank you. There are one or two more questions if you have a time.

Congressman FORBES. Sure.

Chairman D'AMATO. Commissioner Wessel.

Cochair WESSEL. Mr. Forbes, thank you for being here. Thank you for forming this caucus. You're correct in terms of trying to develop the energy and attention to this process. I should point out in response to one comment you made about language skills, we're honored to have several staff on our Commission, as well as Commissioners, who speak and write Chinese. So we understand how valuable those skills are.

We'd like to work with you over the coming weeks as we move forward in enhancing the role, not only of the caucus, but clearly of this Commission, to develop those analytical tools to a greater extent.

There are aggressive espionage efforts and influence peddling activities of the Chinese to influence the debate here in Washington. That needs to be countered with information, what we try and do here, what you're trying to do with the caucus, and we need to build a more robust analytical base to be able to understand how to proceed with the policies on the right course. So thank you for what you're doing and we hope to be able to work with you.

Congressman FORBES. Thank you.

Chairman D'AMATO. Thank you. Commissioner Donnelly.

Commissioner DONNELLY. Thank you. You've touched on a couple of issues that rang bells from my previous life as a staffer on the Armed Services Committee.

In regard to building institutional capacity in the DoD to simply study where China is going, the Chinese military power report that came out just the other day was a product of the mid-'90s, but was fought in a very resistant way by the Department at that time, not so much for partisan reasons, but because of institutional reasons. Since then, I think there has been even less attention paid to building a really robust, call it a "center for the study of Chinese military affairs." There's a lot of material now available that's simply going untranslated and unanalyzed because the DoD does not have sufficient language capacity and analytical capacity to take this wealth of material to inform our dialogue and our debate both here in Washington but in the military and in the military community writ large, to make sure that we have a more profound understanding of what China is thinking about where it wants to go.

So I would call your attention to that track record and hope that the China caucus and you in particular, as a Member of the Committee, will revive that impulse because we really need to have a

go-to cadre of analysts who study this over the course of a life time, who speak Chinese, who also understand strategy.

Many Sinologists love Chinese culture, love language, or are embroiled in economic affairs to the detriment of the study of military affairs and broader political strategy. So again, your committee has a pretty good track record in this. That would be my very small sales pitch to you to try to bring some of that back to center stage and some of the flags have been planted, but they've been inadequately funded, they've been shipped off to Hawaii where they're comfortably swept under the carpet and not much of a nemesis to people in the Pentagon, but that's what their purpose was intended to be.

Congressman FORBES. You hit some key areas, and as you know, one of the things we can't do is pigeonhole it and say this is just DoD because if you look at our trade deficit, for example, and we look at their purchase of weapons, we know that just five years ago, they were going to the Soviets and the people and trying to buy weapons with essentially credit and IOUs, and today they're going with our cash, and so that interrelates.

The other thing is when you look at the EU arms embargo, one of the things that we've explored is that it's great to tell our friends in Europe don't sell them arms, but their defense budget pales in comparison to ours, and if they're stealing our technology, then that's a huge problem, too, and we can't be working on the one hand and not covering the other.

So you're right. We need that comprehensive institutional knowledge and hopefully Chairman Hunter is very supportive of what we're doing. He doesn't join caucuses. But he has joined this caucus. He thinks it's that much of a priority to do.

Chairman D'AMATO. Yes, Commissioner Mulloy.

Commissioner MULLOY. Congressman, thank you for being here. I was in high school when Sputnik went up, and President Eisenhower led the nation on how to grasp and how to prepare ourselves to deal with those challenges. My own view is I don't want to demonize the Chinese. But they do, as you've pointed out, have a national vision and strategy to move their society forward economically and other ways, and we don't.

We've recommended that our country needs a comprehensive national technology and economic strategy, not to be a heavy-handed industrial policy but how to incentivize our own corporations to keep higher value added jobs in our own country.

I believe the Chinese have a strategy to help, to have the foreign companies to help build their industrial base, and they incentivize our companies to do that, and we don't have any counter-strategy in place. I don't demonize the Chinese, but certainly we need to think comprehensively about this, and I salute you for your leadership, and we want to help in every way we can.

Congressman FORBES. Can I just echo on that one because it's an important issue because one of the things that we don't realize sometimes is that we see a big sale that takes place from a corporation in the United States, and we think, oh, boy, this is going to help our trade deficit, but the big questions we have to ask are number one, what percentage of those goods are made in the United States? Oftentimes we're talking about 15 percent. Sec-

only, I always ask them, are we going to get the parts and the service afterwards? And almost never because of Chinese policies are we going to get the parts on the products or the service on it.

The other thing that we've got to be careful about is not being lulled into a belief that we have a technological superiority. There's an individual I know named Warren Katz, some of you know, but I also deal a lot in modeling and simulation. I'm the Chairman of the Modeling and Simulation Caucus, which is huge for us training our jointness in the things that are there.

The Chinese don't oftentimes travel to world conferences, so it's hard to measure where they are in certain technology issues. But Warren will go around. He speaks almost weekly across the world on these issues, an MIT graduate, and you know very well versed in that, but he told me that when he normally comes to the United States or another country, he'll speak. He'll have about 200 engineers that show up to hear him. When he went to China to speak, there were 5,000 engineers that showed up, and they were asking cutting-edge questions, working on cutting-edge products.

The concern for us is that we not get lulled into sleep in being worried that they're going to catch us. We may end up having to catch them if we're not very, very careful. So your comments are excellent and well spoken.

Commissioner MULLOY. We held a hearing on precisely that issue in Palo Alto in April. We'll make sure your staff gets a copy of it.

Congressman FORBES. Good. Thank you very much.

Chairman D'AMATO. Thank you. We have a few more quick comments.

Congressman FORBES. Sure.

Chairman D'AMATO. Commissioner Dreyer.

Cochair TEUFEL DREYER. Yes. I too have a sales pitch just like Commissioner Donnelly. We are delighted your caucus is here since I find that there is a serious lack of hardheaded analysis of China, and a lot of unexamined assumptions. A former Prime Minister of Australia we were talking to a couple of months ago called this the "oh-gosh-gee-whiz" school of China analysis.

In other words, the assumption is that China is an immense juggernaut. Since there is nothing you can do to stop it, therefore you have to accommodate to it. Yesterday, we had a briefing from an intelligence agency in which an analyst stated China is determined to regain its rightful place in the world. What does this mean? What other country would we say had a rightful place in the world? Does Italy deserve to recreate the prestige it had as the Roman Empire? Iran to expand its borders to those of the empire of Cyrus the Great? And if we are discussing Asia, perhaps it's Japan that should regain its "rightful place" as the Empire of the Sun?

So I hope that your caucus will examine these assumptions and not come to conclusions like there is no way we can stop China and therefore we've got to do what it wants.

Congressman FORBES. Excellent, very good.

Cochair TEUFEL DREYER. Thank you.

Chairman D'AMATO. Vice Chairman Robinson.

Vice Chairman ROBINSON. Yes, thank you, again, Representative. I merely wanted to applaud your recommendation that the executive branch requires a standing task force or interagency working group on China. Beyond the issue-by-issue gatherings that would normally take place under the established structures in the interagency community that exists today.

You provided a number of examples of how different agency portfolios are inextricably entwined in looking at any given issue. One that we're examining on August 11 in our capital markets hearing is that the parent companies of Chinese proliferators are today listed on the New York Stock Exchange.

Obviously, this is a Treasury Department issue, it's SEC issue, it's State and it's Defense. It's not the kind of thing that's being looked at today and the American people are holding in portfolio some of these companies that we would find to have engaged in security-related abuses. This is merely one of many such examples.

All I can say is that I think we are as a Commission seized by the desire to have the executive branch follow in the model that you've put together in the caucus and frankly that we represent here in this kind of more-studied integrated effort, and we thank you for it.

Congressman FORBES. Good.

Chairman D'AMATO. Again, thank you very much for coming and visiting with us this morning.

Congressman FORBES. Thank you, Mr. Chairman.

Chairman D'AMATO. We look forward to working with you, Congressman.

Congressman FORBES. Thank you.

Chairman D'AMATO. Thank you. We'll take a five-minute break. [Whereupon, a short break was taken.]

PANEL II: CHINA'S FUTURE ENERGY DEVELOPMENT AND ACQUISITION STRATEGIES

Chairman D'AMATO. Good morning and welcome to the U.S.-China Economic and Security Review Commission's hearing on China's Growing Global Influence: Objectives and Strategies. This hearing is being cochaired today by Commissioners Carolyn Bartholomew, June Dreyer and Michael Wessel.

China's influence—diplomatic, economic and military—is growing on nearly every continent. China's quest for energy and commodities is a central reason for that country's increasing activities and presence around the globe. They're on a hunt for energy, on a hunt for commodities, and a part of this Commission's mandate is to assess how China's growing economy is affecting the world's energy supplies and demand-driven behavior.

This Commission has deep reservations about the acquisition attempt by CNOOC, the Chinese state-owned oil company, their attempt to acquire an American private oil company, Unocal. We've made our position fairly clear.

Over the next two days, we'll be discussing what is driving China's approach to various regions, and the tools it is using to reach its goals. We will also be looking at how Beijing approaches discrete regions including Asia, Africa, Latin America, how this activ-

ity may affect the United States and our interests, to what extent its competitive, to what extent it can be cooperative?

China's industrialization and the increasing income among some sectors of the Chinese population is fueled by industrialization and has been producing a dramatic increase in demand for raw materials, energy and consumer goods. This rapid increase in energy requirements—in 1995 China was an exporter of oil and now importing three million barrels a day. In 15 years, it will be importing nine or ten million barrels a day according to current projections. The rapid increase in energy requirements has led China to establish and strengthen relationships with oil producing countries in the Middle East, Africa, and even our backyard, countries of Canada and Venezuela.

We need to evaluate China's energy strategy, the way it goes about procuring energy, and its implications for U.S. national security. This, of course, is the central question in the matter of CNOOC's attempted acquisition of Unocal.

The search for such resources is also leading China to ally itself with countries such as Sudan and Iran that are of concern to the United States because of their poor human rights records, undemocratic governments, contributions to regional instability, in return for long-term oil contracts.

Beijing's diplomatic, economic and/or military support for these nations frustrates some of our efforts and efforts of other countries and international organizations to obtain responsible changes and improvements in their behavior.

It is imperative for Washington to understand China's global objectives, the resulting implications for the U.S. and how as a nation we should respond. In particular it is vital for Congress to make knowledgeable and informed decisions. Our purpose here is to help Congress collect information, evaluate the information it needs in this respect.

I'd now like to turn over the microphone to Vice Chairman Roger Robinson.

OPENING STATEMENT OF VICE CHAIRMAN ROGER W. ROBINSON, JR.

Vice Chairman ROBINSON. Thank you, Mr. Chairman. I too wish to welcome both of you to today's hearing on China's Growing Global Influence: Objectives and Strategies. Like the Chairman, I'm concerned about a number of the downside risks for U.S. interests associated with China's dramatic rise.

China's presence is growing in many parts of the world and as stated earlier today at high velocity. China is strengthening ties with traditional U.S. allies such as Germany, Israel and Australia. Such ties in the future require or may require those who have been our traditional friends and supporters to choose sides on certain issues between the U.S. and China.

We must gain a better understanding, therefore, of China's economic and security strategies and at the same time persuade our allies not to sacrifice long-term security interests for short-term economic and financial gain, which I think has been the nub of our problem up until this time.

China is not only reaching out to our friends, but also to countries of concern. This is especially true in connection with China's

quest for energy that the Chairman has just cited which has led them approach again Cuba, Iran, Sudan, Zimbabwe, for oil and oil-related commodities.

In fact, as the Chairman also mentioned, China's prodigious demand for energy has led it to Canada for tar sands and even to Wall Street as illustrated by CNOOC's subsidized proposal to purchase Unocal.

Beijing recently criticized Congress for its efforts to question this transaction and told our lawmakers to, quote, "stop interfering in the normal commercial exchanges between enterprises of two countries."

The Chinese government didn't mention in this statement that it owns the majority of CNOOC and this enterprise has access to substantial below-market government financing of a type not available to its Western competitor.

This proposed transaction has certainly had a beneficial consequence. It has awakened many in our country to the reality that the Chinese government is aggressively pursuing its goals in the U.S. and around the world as well as our need to focus on certain of their methods.

In addition to the Members of Congress that we've heard from today, I very much look forward to hearing from other experts like yourself who will be testifying and I'd like now to turn over the proceedings to a Cochair of today's hearing, Commissioner Carolyn Bartholomew.

[The statement follows:]

Prepared Statement of Vice Chairman Roger W. Robinson, Jr.

Good morning and thank you Chairman D'Amato. I, too, welcome you to the U.S.-China Economic and Security Review Commission's hearing on *China's Growing Global Influence: Objectives and Strategies*.

Like the Chairman, I am also concerned about some of the downside risks for U.S. interests associated with a rising China. China's presence is growing in many parts of the world, and at a high velocity. China is strengthening ties with traditional U.S. allies—such as Germany, Israel and Australia. Such ties could in the future require those who have been our friends and supporters to choose sides between the U.S. and China on certain issues. We must gain a better understanding of China's global economic and security strategy and, at the same time, persuade our allies not to sacrifice long-term security interests for short-term economic and financial gain.

China is not only reaching out to our friends, but also to countries of concern. This is especially true in connection with China's quest for energy, which has led it to approach, among others, Cuba, Iran, Sudan and Zimbabwe for oil and related commodities.

In fact, as Chairman D'Amato mentioned, China's prodigious demand for energy has led it to Canada for its tar sands and even to Wall Street, as illustrated by CNOOC's subsidized proposal to purchase Unocal. Beijing recently criticized Congress for its efforts to question this transaction and told our lawmakers to "stop interfering in the normal commercial exchanges between enterprises of two countries." The Chinese government did not mention in this statement that it owns a majority of CNOOC and this enterprise has access to substantial below-market government financing of a type not available to its U.S. competitor.

This proposed transaction has certainly had a beneficial consequence: It has awakened many in our country to the reality that the Chinese government is aggressively pursuing its goals in the U.S. and around the world, as well as the need to focus on certain aspects of their methods.

I very much look forward to hearing from the Members of Congress with us today, and other experts who will be testifying.

I'd like to now turn over the proceedings to Commissioner Carolyn Bartholomew, a Cochair of this hearing.

**OPENING STATEMENT OF COMMISSIONER CAROLYN BARTHOLOMEW
HEARING COCHAIR**

Cochair BARTHOLOMEW. Thank you, Mr. Vice Chairman. Thank you, Mr. Chairman, and thank you to our witnesses who appear today. Before we turn the hearing over to Commissioner Wessel for the energy panels, I would like to make a few opening remarks.

Senator Feingold this morning referred to the Chinese government's energized campaign of engagement in the world. That's one of the driving motivations frankly for this hearing. One of the difficulties we have putting together any of these hearings is that events on the ground can change as we are in the process of finalizing our agenda and our witness lists.

I'm always grateful to the fact that witnesses are willing to drop what they are doing and come here to Washington in order to testify in front of us. But there are two events that have happened over the course of the past few weeks that we really can't adequately reflect on today. I'll refer to it as the tickle of the Chinese currency. We've yet to see how that plays out. The story has just happened this morning, and on Tuesday evening, I believe it was, the Department of Defense released its annual report on Chinese military power.

The Vice Chairman has mentioned CNOOC. I think that the CNOOC deal really raised a lot of questions in a lot of people's minds about what is the Chinese government's intentions. There were questions, both about what would the consequences in our own hemisphere be if the Chinese owned energy assets here on United States territory as well as what are the concerns and questions that would be raised in many of the assets, particularly liquefied natural gas, that Unocal is control of in Asia.

All of these issues raise continuing questions that we are trying to focus on today. I wanted to mention briefly a couple of points about the DoD's report that just came out that raised important questions.

One is that the report explicitly states that if current trends continue, the PLA poses a credible threat to other militaries operating in the region. The Chinese continue to invest heavily, particularly in power projection, and that there is a striking new focus in the report on evidence that the PLA buildup is aiming beyond Taiwan.

Those are all questions that our panelists today have observations on. I don't know that we'll be asking them specific questions, since we really haven't had a chance to review the report ourselves, but this is the context in which we are holding today's hearings. Finally, I think that there are important questions about capabilities and intentions. We clearly have insufficient information about what the Chinese government capabilities are, and we have an incomplete understanding about what their intentions are in terms of their roles in the world.

So with that stage setting, we've got a lot to ground to cover ahead of us. We've got a day-and-a-half to cover. Frankly any of these panels could have gone on for a day-and-a-half. We're starting with the important issue of energy and I'd like to turn it over to Commissioner Wessel.

[The statement follows:]

**Prepared Statement of Commissioner Carolyn Bartholomew
Hearing Cochair**

Thank you very much, Mr. Vice Chairman. And thank you, Mr. Chairman, and thanks to our witnesses who appear today. Before we turn the hearing over to Commissioner Wessel for the energy panel, I would like to make a few opening remarks.

Senator Feingold this morning referred to the Chinese government's energized campaign of engagement in the world. That's one of the driving motivations for this hearing. We have an excellent group of witnesses with whom to discuss this topic and I am always grateful that witnesses are willing to drop what they are doing and come to Washington in order to testify to this Commission.

There are also certain events that have occurred over the course of the past few weeks that require attention and which we hope to discuss during this hearing. One is the issue of the Chinese currency exchange rate. The other is the annual report, released earlier this week by the Department of Defense, on Chinese military power. This report raises important issues. One is that, as the report explicitly states, if the current Chinese military build-up continues, the PLA will pose a credible threat to other militaries operating in the region. China continues to invest heavily in its military, particularly in power projection. There is a striking new focus in the report—that the PLA's build-up is aiming beyond Taiwan.

The CNOOC deal is also an issue and raises numerous questions about China's energy policies and the resulting implications for the United States. What would the consequences be if the Chinese owned energy assets on U.S. territory?

And finally, I think that there are important questions about China's global intentions and capabilities. We clearly have insufficient information about what Beijing's capabilities are, and we have an incomplete understanding about what intentions are driving China's global approach.

These are all important questions that we would like to cover with our panelists, giving us much to address in the next two days. We are starting with the important issue of energy and I'd like to turn the hearing over to Commissioner Wessel.

**OPENING STATEMENT OF COMMISSIONER MICHAEL R. WESSEL
HEARING COCHAIR**

Cochair WESSEL. Thank you to the hearing Cochairs, the Chairman and the Vice Chairman, as well as our previous panel.

Cochair BARTHOLOMEW. Everybody has got a chair name today.

Cochair WESSEL. I think I've labeled everyone.

Cochair BARTHOLOMEW. Witness chair.

Cochair WESSEL. Witness chair. The Commission will first hear from a panel that will examine and assess the economic and geopolitical implications of the PRC's energy-driven global expansion policy and what implications that has for the U.S. and world energy markets.

In recent weeks, China's energy demands and approach to acquiring energy has catapulted to be one of the top issues on Washington's policy agenda in light of CNOOC's bid to acquire Unocal. That bid has raised questions about the importance of energy, whether it is a national security asset, and what are China's short and long-term energy acquisition strategies.

China's energy needs and acquisition strategies are not new issues for this Commission. In October of 2003, the Commission held a hearing on this important topic. In its transmittal letter forwarding our hearing record to Congress, the Commission stated that, quote: "China's growing energy demands, particularly its increasing reliance on oil imports, pose economic, environment and geostrategic challenges to the United States."

Indeed, the Commission has also warned that, quote: "A key driver in China's relations with terrorist-sponsoring governments is the dependence on foreign oil to fuel its economic development. This dependency is expected to increase over the coming decade."

Since our hearing, China's energy demands have accelerated and, with it, their impact on world energy markets. Some estimates indicate that China accounts for 40 percent of the increase in world oil demand. That has, of course, helped to contribute to the spike in oil prices to today's levels that are hovering around \$60 a barrel.

China's dramatic economic growth rates, manufacturing expansion and modernization efforts are fueling their increased demand for energy. That issue in and of itself requires study. Are adequate steps being taken to implement energy efficiency strategies? Is China pursuing adequate efforts to promote new technologies and diversify energy supplies?

Those are, of course, issues that the U.S. Congress is also wrestling with as it seeks to update on own energy policies here at home.

But there are other important implications of China's dramatic demand increases for energy. And those are how China seeks to meet its demands on the world energy markets. Those acquisition strategies are what we will discuss with our first panel this morning.

Our first panelists are distinguished experts and analysts, and we do appreciate your being here. We know you're taking time out of your busy schedules.

Dr. Gal Luft is the Executive Director of the Washington, D.C. based Institute for Analysis of Global Security. He specializes in strategy, geopolitics, terrorism, the Middle East and energy security. He is also an Associate Fellow at the Washington Institute for Near East Policy.

Our other panelist is Fareed Mohamedi, of PFC Energy where he is the Chief Economist and Senior Director of the Country Strategies Group. This group houses the firm's expertise in country risk and petroleum sector policy.

He has broad experience in the area having served at Moody's Investors Services where he was the lead country analyst for a number of petroleum and gas-producing countries. He has also worked as an economist at the Institute of International Finance in the Middle East and Asia departments, at the World Bank's Africa Department, at Wharton Econometrics Forecasting Associates' Middle East Service and at the economics research section of the Ministry of Finance and National Economy in Bahrain.

As is our normal practice, we'd like our panelists to restrict their oral comments to seven minutes, and then we will restrict our Commissioners and their time as well so that we can have a good discussion and hopefully full round of questioning.

With that, Dr. Luft, if you could start, we'd appreciate it.

[The statement follows:]

**Prepared Statement of Commissioner Michael R. Wessel
Hearing Cochair**

The Commission will now hear from a panel that will examine and assess the economic and geopolitical implications of the PRC's energy-driven global expansion policy and what implications that has for the U.S. and world energy markets.

This examination is required by the statute governing the Commission. The statute requires that we "evaluate and assess how China's large and growing economy will impact upon world energy supplies and the role the United States can play, including joint R&D efforts and technological assistance, in influencing China's energy policy."

In recent weeks, China's energy demands and approach to acquiring energy has catapulted to be one of the top issues on Washington's policy agenda in light of CNOOC's bid to acquire Unocal. That bid has raised questions about the importance of energy, whether it is a national security asset, and what are China's short- and long-term energy acquisition strategies.

I should note the Commission's disappointment that the Bush Administration declined our invitation to testify on China's energy policies. They wanted to reserve their testimony for the hearing that will be held tomorrow on the proposed acquisition of Unocal.

China's energy needs and acquisition strategies are not new issues for this Commission. In October of 2003, the Commission held a hearing on this important topic. In its transmittal letter forwarding our hearing record to Congress, the Commission stated that "China's growing energy demands, particularly its increasing reliance on oil imports, pose economic, environmental, and geostrategic challenges to the United States." Indeed, the Commission has also warned that "(a) key driver in China's relations with terrorist-sponsoring governments is its dependence on foreign oil to fuel its economic development. This dependency is expected to increase over the coming decade."

Since our hearing, China's energy demands have accelerated—and with it, their impact on world energy markets. Some estimates indicate that China accounts for 40% of the increase in world oil demand. This has, of course, helped to contribute to the spike in oil prices to today's level that is hovering around \$60 a barrel.

China's dramatic economic growth rates, manufacturing expansion and modernization efforts are fueling their increased demand for energy. That issue, in and of itself, requires study: are adequate steps being taken to implement energy efficiency strategies? Is China pursuing adequate efforts to promote new technologies and diversify energy supplies? Those are, of course, issues that the U.S. Congress is also wrestling with as it seeks to update our own energy policies here at home.

But, there are other important implications of China's dramatic demand increases for energy—and those are how China seeks to meet its needs on the world energy markets. Those acquisition strategies are what we will discuss with our next panel this morning.

China is pursuing an entirely different strategy on energy acquisition than the U.S., or its major allies are pursuing. Our actions are market based—no one questions that our major oil companies intend to sell their products to the highest bidder. The major oil companies are engaging in a free market approach.

China, on the other hand, wants to own oil and other energy assets, at the well-head. Their energy acquisition strategy is mirrored in their efforts to acquire other resources such as iron ore, nickel and other commodities. They are willing to pay a premium for these assets now to ensure captive supplies for the future.

China views this as a national security issue and has linked its military, diplomatic and political efforts in the world to their energy acquisition strategy. They have entered into energy acquisition deals with Iran, Sudan and other nations to ensure their access to energy. In return, they have transferred military equipment, technology, and cash and have agreed to support the political aims of those and other countries. Their efforts extend to blocking action at the United Nations for the call for action against the genocide in Sudan. They have transferred, and been sanctioned for, their shipments of advanced missile technology to Iran. They are reaching out to countries across the globe—many of which have serious implications for U.S. security interests.

Today's hearing is not intended to be a debate about the effort of CNOOC to acquire Unocal. That issue is being debated in Congress as it continues its four year effort to pass energy legislation. While the CNOOC bid is certainly an appropriate topic for our review, our hearing is intended to provide a much broader update on China's energy needs and strategies for meeting those needs. The CNOOC bid is an important transaction—but it is only emblematic of China's broader energy acquisition strategies.

Our first panelists are distinguished experts and analysts.

Dr. Gal Luft is Executive Director of the Washington, D.C. based Institute for Analysis of Global Security. He specializes in strategy, geopolitics, terrorism, the Middle East and energy security. He is also an associate fellow of the Washington Institute for Near East Policy.

Our other panelist is Fareed Mohamedi of PFC Energy where he is the Senior Director of the Country Strategies Group. This group houses the firms expertise in country risk and petroleum sector policy. He has broad experience in the area having served at Moody's Investors Service where he was the lead country analyst for a number of petroleum and gas producing countries. He has also worked as an economist at the Institute of International Finance in the Middle East and Asia depart-

ments, at the World Bank's Africa department, at Wharton Econometrics Forecasting Associates' Middle East Service and at the economics research section of the Ministry of Finance and National Economy in Bahrain.

**STATEMENT OF GAL LUFT
EXECUTIVE DIRECTOR
INSTITUTE FOR THE ANALYSIS OF GLOBAL SECURITY (IAGS)**

Dr. LUFT. Thank you. Good morning to all the Chairs. Thank you for inviting me.

Cochair BARTHOLOMEW. Multitude of chairs.

Dr. LUFT. Let me start with one piece of good news. I think that the Unocal affair did one good thing to all of us, and that is the fact that it brought to the fore the debate about whether or not China's pursuit of oil is a threat to U.S. national security. Many of those who think that it is not including some of the leading media outlet—Newsweek magazine called the concern over the top; The Economist called the response by Congress to be farcical; The Wall Street Journal said that the fact that a Chinese oil company wants to buy an American one is a sign of progress, not concern—so in light of all of this, I think that this hearing is very timely and proper.

There is always a chance that China's pursuit of energy could present an opportunity to enhance cooperation, integration, and interdependence with the United States. But it is also likely that aggressive competition over access to energy sources will ensue. With global reserves of cheaply recoverable oil and gas being depleted, China is already competing with the United States over the same oil reserves in some of the world's most unstable and volatile areas.

Former Secretary of State Henry Kissinger warned recently that a global battle for control of energy resources could become the modern equivalent of colonial disputes of the 19th century.

Energy is the main driver of China's recent international behavior. In a lecture at Beijing University in March of 2004, China's Deputy Foreign Minister Yang Wi admitted that Chinese foreign policies are, quote, "at the service of China's economic development."

This is a very accurate description of what's going on. China's energy expediency is affecting its international behavior to the detriment of the United States. In the past year alone there have been at least three manifestations of this pattern. One is Iran. We know Iran is a major energy supplier for China, and while the United States and the European Union try to forge diplomatic strategy to halt nuclear program, China's energy deal with Iran brought it to block any American attempt to refer Iran's nuclear program to the Security Council.

The second case is Sudan. As discussed here, the Security Council passed a resolution threatening Iran with sanctions unless it curbed its support for belligerent militia groups in Darfur. Again to protect its oil interests in Sudan, Beijing stated very clearly that it would veto any bid to impose such sanctions.

The most recent manifestation is Uzbekistan where the United States has an Air Force Base, which serves our military operations in Afghanistan. In May of 2005, as you all know, Uzbeki military massacred hundreds of civilians in Andijan. While most of the

world denounced the killing, calling for international investigation, China immediately announced its steadfast support for Islam Karimov in his so-called “war on terrorism” and rejected calls for international investigation of the massacre.

Several days later, a \$600 million energy deal between China and Uzbekistan was signed. China was quick to capitalize on the crisis in Washington’s relations with Karimov, and most recently this month, the meeting of the Shanghai Cooperation Organization, China was the leading force behind an effort to rid of the region of American military presence and curb U.S. influence in Central Asia.

All of these cases show that China assigns greater weight to lucrative supplies of crude oil than it does to efforts to strengthen international cooperation on critical global security issues and the rule of law.

The case of Iran indicates that China might be interested in a militarily strong even nuclear Iran that could challenge U.S. domination in the Persian Gulf.

I would like to touch very briefly on three areas of concern. One is the Middle East. I talked about Iran, but there is also the biggest price in the Middle East is the Saudi Arabia, home of a quarter of the world’s oil reserves. In 199, China announced a Sino-Saudi “strategic oil partnership” with Saudi Arabia, and Saudi Arabia became the largest supplier of crude oil to China.

The Saudis have recently demonstrated their intention to strengthen the bond with China even further, deciding last year to allow Chinese firms to explore Saudi natural gas fields, which is a very rare thing.

This month Saudi Arabia’s national oil company Aramco became a 25 percent investor in the biggest refinery and petrochemical integrated project China has ever entered with a foreign entity.

China would like to see a gradual shift of allegiance from Washington to Beijing. The Saudis for their part still rely on the United States for their security, but I believe that further deterioration in U.S.-Saudi relations, for example, if one day there is another terror attack conducted by Saudi nationals, which is not very unlikely, combined with growing Chinese military buildup, that could eventually bring the House of Saud to the open arms of the Chinese, and we need to look at this very carefully.

The other area of concern is East Asia, or the East China Sea in particular. There China is involved in territorial disputes with Japan over energy resources in the Senkaku Island, which was used to be, by the way, a U.S. territory. Both China and Japan have already sent their oil companies to explore in this area, and have created a lot of tension. In fact, I think the situation in the East China Sea is explosive.

In November of 2004, we had a Chinese submarine illegally penetrated the area. In response, in February of 2005, Tokyo took formal possession of an island provoking the very harsh Chinese rhetoric. In April, China sent an official warning to Japan to back off or to quote, “take full responsibility.”

Japan’s Defense Ministry drew up contingency plans to deploy 55,000 troops in the event of Chinese invasion of the disputed islands. This tense atmosphere is feeding popular and political ani-

mosity that has already resulted in a wave of violent anti-Japanese demonstrations in April and is likely to deepen over time.

There are other sources of tension between China and Japan unrelated to energy, but continuous resource competition would surely exacerbate long-standing Sino-Japanese tensions even further and hence disrupt the delicate regional balance that has been maintained by the United States since the end of the Second World War.

The last area of concern I would like to touch upon is the Western Hemisphere and there has been a lot of talk about China's acquisition and interest in all these countries, including Peru, Cuba, Ecuador, Argentina, Brazil, Venezuela, and Canada. What does this all mean really?

Perhaps the single-most important thing that I would like this Commission to realize is that China's energy acquisitions in the Western Hemisphere will eventually make the United States more dependent on the Middle East and other volatile areas of the world. With half of our oil imports coming from the Western Hemisphere and with our own oil consumption projected to surge by 60 percent during the next two decades, the United States cannot lose chunks of Western Hemispheric crude.

Every barrel of oil that China buys in America, whether it is North America, Central America or Latin America, essentially means one less barrel available for the U.S. market. This means that the United States will have to look for this oil elsewhere and become more reliant on oil from more remote and less stable regions, primarily West Africa, the Caspian, and above all the tumultuous Middle East. This is contrary to President Bush's pledge to make the United States less dependent on, quote, "countries that don't particularly like us."

Cochair WESSEL. If you could finish up, please.

Dr. LUFT. So I think that whether there will be a clash or confrontation overall depends on many issues I can discuss later. But definitely we see that the last couple of years, we've seen very alarming trends, and we need to remember the China is only in the first steps of its growth. If we carry this process forward ten, 20 years from now, we'll definitely see that there will be many grounds for conflict and U.S. national security could be severely compromised.

Thank you.

**Prepared Statement of Gal Luft
Executive Director, Institute for the Analysis of Global Security (IAGS)**

Mr. Chairman, Members of the Commission, my name is Gal Luft. I am executive director of the Institute for the Analysis of Global Security (IAGS), an energy security think tank which for the past three years has followed and analyzed China's foreign, economic and security policies, which stem from its growing energy consumption, and their impact on global security. I would like to thank you for inviting me to brief you on China's energy policy and its effects on U.S. interests.

Since it became a net oil importer in 1993, China has traversed the globe in a relentless quest for energy sources to fuel its booming economy. In recent years its state owned energy companies concluded oil and gas deals in close to 30 countries. There is no doubt that China's robust economic growth has already been felt on the global energy scene and contributed substantially to this year's spike in oil prices. In some cases, China's pursuit of oil has caused considerable irritation in Washington. The latest of these is the decision of China National Offshore Oil Corporation (CNOOC) to bid for Unocal, America's ninth largest energy company.

The Unocal affair brought to the fore the debate whether or not China's pursuit of oil is a threat to U.S. national security. Many of those who decry scrutiny of this deal see no harm in a proxy of China's Communist government gaining foothold in the U.S. economy. *Newsweek Magazine* called the concern "over the top"; the *Economist* called the response by Congress "farfical" and the *Wall Street Journal* said: "The fact that a Chinese oil company wants to buy American is a sign of progress, not concern." But at a time of short supply of oil, when oil prices reach a historic high of \$60 per barrel, a Chinese attempt to buy a piece of America's energy is not a trivial matter. It should invoke a serious discussion about the future of America's energy and economic security in light of China's rise.

Though there is always a chance that China's pursuit of energy could present an opportunity to enhance cooperation, integration and interdependence with the U.S., I believe that it is more likely that aggressive competition over access to energy sources will ensue. With global reserves of cheaply recoverable oil and gas being depleted China is already competing with the U.S. over the same oil reserves in some of the world's most unstable areas. Former Secretary of State Henry Kissinger warned recently that the global battle for control of energy resources could become the modern equivalent of the colonial disputes of the 19th century.

Energy is the main driver of China's recent international behavior. In a lecture at Beijing University in March 2004, its deputy foreign minister, Wang Yi, admitted that Chinese foreign policies are "at the service of China's economic development." Our independent analysis has confirmed just that. I would like to focus on four regions where China's energy expediencies affect its international behavior to the detriment of the U.S.: the Middle East, the East China Sea, Central Asia and the Western Hemisphere.

The Middle East

Close to 60 percent of China's oil imports come from the Middle East and its imports from there are projected to grow by more than 500 percent by 2030. China is already making its presence felt with money, arms and diplomacy, moving to fill the widening post-September 11 fissures between the U.S. and countries like Saudi Arabia and Iran.

A recent manifestation of how China's approach to oil puts it in conflict with vital U.S. interests is its partnership with Iran. China is the number one oil and gas importer from Iran. The two countries are bound by energy deals reaching a total value of \$120 billion and growing. While the U.S. and the EU are trying to forge a diplomatic strategy to halt Iran's nuclear program, China's October 2004 energy deal with Iran brought it to block any American attempt to refer Iran's nuclear program to the U.N. Security Council. This indicates not only that China is interested in a militarily strong, even nuclear Iran that could challenge U.S. domination of the Persian Gulf but also that for China, energy security considerations trump international cooperation on critical global security issues.

Another example is Sudan, which supplies seven percent of China's oil imports. The Chinese have invested billions of dollars in joint exploration contracts in this country, including the building of a 900-mile pipeline to the Red Sea. China deployed thousands of military personnel disguised as oil workers and provided arms to the Sudanese government to support it in the country's 20-year civil war. Last September, the U.N. Security Council passed resolution 1564, threatening Sudan with oil sanctions unless it curbed its support for belligerent militia groups in Darfur. To protect its oil interests in Sudan, Beijing stated very clearly that it would veto any bid to impose such sanctions. This case, again, shows that China assigns greater weight to lucrative supplies of crude oil than it does to efforts to halt a government sponsored genocide.

Without doubt the biggest prize in the Middle East is Saudi Arabia, home of a quarter of the world's oil reserves. Since its 1999 pronouncement of a Sino-Saudi "strategic oil partnership," Saudi Arabia became the largest supplier of crude to China. The Saudis have recently demonstrated their intention to strengthen the bond with China even further, deciding in 2004 to allow Chinese firms to explore Saudi natural gas fields while negotiations between Riyadh and U.S. companies failed to bear similar fruit. This month Saudi Arabia's national oil company Aramco became a 25% investor in the biggest refinery and petrochemical integrated project China has ever entered with a foreign entity. China would like to see a gradual Saudi shift of allegiance from Washington to Beijing. The Saudis, for their part, still rely on the U.S. for their security but further deterioration in U.S.-Saudi relations—for example in the case of another terror attack by Saudi nationals against the U.S.—combined with growing Chinese military buildup could eventually bring the House of Saud to the open arms of the Chinese. In order to guarantee a market in China the Saudis have interest in building capacity to process their heavier Ara-

bia crude. To this end, Saudi Arabia has been investing in China's refining industry, projected to expand by nearly 30 percent within the next five years.

East Asia

In the East China Sea, China is involved in territorial disputes with Japan over energy resources in the Senkaku Islands. The tiny archipelago, which was a U.S. territory before it was handed to Japan, is still used by the U.S. military as practice grounds for bombing runs. China has already begun the exploring process for gas reserves on its side of the East China Sea. The Japanese government claims that some of the reserves are actually on its side of the demarcation line and has accused China of attempting to extract hydrocarbons from its water. It also allowed its own oil firms to drill in the disputed territories—a move considered a provocation by China. The situation in the East China Sea is explosive. In November 2004 a Chinese nuclear submarine illegally penetrated Japanese water. In response, in February 2005 Tokyo took formal possession of Senkakus, provoking harsh Chinese rhetoric. On April 14, China sent an official warning to Japan to back off or “take full responsibility.” Japan's defense ministry drew up contingency plans to deploy 55,000 troops in the event of a Chinese invasion of the disputed islands. This dispute is exacerbated by tension between Japan and China over access to Russian oil. For many months, China and Japan have been involved in a bidding war over a major pipeline deal to deliver Russian oil from Eastern Siberia. China's plan calls for a pipeline running to the Manchurian city of Daqing, while Japan is insisting on a pipeline that would run to Nakhodka, the Russian coastal area opposite to Japan.

This tense atmosphere is feeding popular and political animosity that has already resulted in a wave of violent anti-Japanese demonstrations in April 2005, and is likely to deepen over time. A survey last year found that 58% of Japanese see China as an emerging threat. There are other sources of tension between Japan and China, unrelated to energy. But continuous resource competition would surely exacerbate long-standing Sino-Japanese tensions even further and hence disrupt the delicate regional balance that has been maintained by the U.S. since the end of the Second World War.

Central Asia

In Central Asia, a major reservoir of oil and gas, China has had a long-standing interest in ensuring that it enjoys unfettered access to natural resources. The two countries of particular importance for China are Kazakhstan and Uzbekistan, both important allies of the U.S. in the war on terrorism and both important sources of energy. China and Kazakhstan have formed a strategic partnership primarily focused on linking the two nations with oil and gas pipelines. So far Kazakhstan has been skillful in balancing the interests of both the U.S. and China.

The same cannot be said about Uzbekistan, where the U.S. has an air force base which serves U.S. military operation in Afghanistan. In May 2005, Uzbekistan's President Islam Karimov massacred hundreds of his own citizens in Andijan. While most of the world denounced the killing, calling for international investigation, China immediately announced its steadfast support for Karimov in his so called “war on terrorism” and rejected international investigation of the massacre. A few days later a \$600 million energy deal between China and Uzbekistan was signed. China was quick to capitalize on the crisis in Washington's relations with Karimov. In this month's meeting of the Shanghai Cooperation Organization it was a leading force behind the effort to rid the region of American military presence and curb U.S. influence in Central Asia.

The Western Hemisphere

China's oil thirst has already resulted in a series of deals stretching from the southern tip of South America to the Caribbean, areas which constitute America's backyard.

- In January 2005, China and **Peru** signed a memorandum of understanding allowing China to promote investments and technical cooperation in the exploration and export of oil and gas.
- In the same month China Petroleum & Chemical Corporation, or SINOPEC, signed a production contract with **Cuba**.
- While U.S. energy companies have grown increasingly disenchanted with the corruption and volatile politics of **Ecuador** and its energy company Petroecuador, the Chinese seem to be undeterred from investing more than \$100 million into drilling and exploration work there.
- **Argentina** and China signed cooperation deals that could lead to up to \$5 billion in investments over the next decade in oil and gas exploration.

- In **Brazil**, the Chinese President signed 11 bilateral agreements, including planned investment of \$10 billion in energy and transportation in the next two years.
- In January 2005 the *Wall Street Journal* reported that trade officials in **Mexico** said they see China as a potential growth market for their oil exports.
- Chinese state-owned oil companies pursue ambitious deals in **Canada**, the top petroleum supplier to the U.S. Canada has emerged as the second largest oil reserve in the world due to the drop in price in the recovery of crude from the vast reserve of Alberta's tar sands. Chinese companies are negotiating the acquisition of Canadian tar sands companies and have already bought stakes in a few of them. The Chinese PetroChina International signed an agreement with Canada's giant pipeline company Enbridge to build a \$2.5 billion pipeline from Alberta to the Pacific coast from where 200,000 barrels of crude a day will be shipped to China. The two countries signed the Canada-China Statement on Energy Cooperation in the 21st Century, promising to work closely in the areas of oil, gas, oil sands, energy efficiency, environment, and related ventures. Analysis conducted by IAGS shows that if China succeeds in acquiring portions of Canada's energy industry up to a third of Canada's potential exports to the U.S. could eventually be lost to China.
- Last but not least is **Venezuela**, U.S.' fourth largest oil supplier. Since April 2002, U.S. relations with Venezuela have become increasingly acrimonious. Venezuela's President Hugo Chavez warned the U.S. against any interference with Venezuela's internal affairs threatening that Venezuela "has enough allies on this continent to start a 100-year war," and that "U.S. citizens could forget about ever getting Venezuelan oil." This threat is not being ignored. Secretary of State Condoleezza Rice remarked in her confirmation hearing that two of her chief worries with regards to Venezuela are U.S. dependence on Venezuelan oil and whether Chavez will continue to supply it. The fissure in the relations enables China to step in and reduce Venezuela's dependence on selling oil to the U.S., which currently buys 60 percent of Venezuela's crude. A series of oil agreements signed in early 2005 allow Chinese companies to explore for oil and gas and set up refineries in Venezuela. Chinese companies agreed to invest \$350 million in 15 oil fields in eastern Venezuela, along with \$60 million in a gas venture, and to import 120,000 barrels of Venezuelan fuel oil a month. For now Venezuela's ability to become a major oil supplier to China is limited. China's refineries are not equipped to refine Venezuela's crude. Geography is also a constraint. Venezuela has no access to the Pacific shore and the Panama Canal cannot accommodate the biggest tankers. But China and Venezuela are trying to resolve these problems. In July 2004 Venezuela signed a contract with Colombia to build a crude oil pipeline connecting its oil fields with a port on Colombia's Pacific coast sparing Chinese tankers the need to traverse the Panama Canal.

The single most important thing to remember about China's energy acquisitions in the Western Hemisphere is that they will eventually make the U.S. more dependent on the Middle East and other volatile areas. With half of its oil imports coming from the Western Hemisphere, and with oil imports projected to surge 60 percent during the next two decades due to demand growth and a decline in domestic crude production, the U.S. cannot afford to lose chunks of Western Hemispheric crude. Every barrel of oil China buys in the Americas essentially means one less barrel available for the U.S. market. This means that the U.S. will have to look for this oil elsewhere and become more reliant on oil from more remote and less stable regions, primarily West Africa, the Caspian and, above all, the tumultuous Middle East. This is contrary to President Bush's pledge to make the U.S. less dependent on "countries that don't particularly like us."

Politically, China's foothold in the Western Hemisphere could reach a stage in which it infringes on the long-standing principle in U.S. foreign policy of non-intervention in the Western Hemisphere by foreign powers. Furthermore, control of energy assets by a Communist government could expose U.S. neighbors to Chinese pressure to part ways from the U.S. on issues regarding China like human rights abuses, arms sales and mainland's relations with Taiwan. Chinese penetration into Latin and Central America could also strengthen the voices of Marxism and anti-Americanism in a part of the world critical to U.S. national security.

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China's drive into the world's energy market has already added a degree of agitation to Sino-American relations and may continue to create occasional friction, as

its state owned companies dig deeper and wider in areas where the U.S. has strategic interests.

The U.S. deploys forces and provides military assistance in the Persian Gulf, Central Asia, and West Africa—all of them are oil rich domains, yet all of them are also critical for America's war on terrorism. China's creation of a foothold in these areas, enabled by its energy relations, could compromise U.S. strategic posture and complicate its campaign against terrorism.

However, this does not necessarily mean that a superpower conflict over oil is inevitable. Energy security is but one of several issues, such as trade, human rights, weapons proliferation and Taiwan, that will affect future Sino-American relations. Each of those issues in itself could strain relations between the two powers. It is also unclear how other large energy consumers like Japan, India and Europe will position themselves on the global chessboard as *their* demand for oil grows.

Whether an oil conflict will develop depends on three major factors. The first is the sustainability of China's astonishing economic growth. China has all the ingredients of rapid growth: its per capita income is still relatively low, so it has huge potential to improve efficiency and grow; it is a drawing ground for foreign direct investment; its labor force is cheap yet hard working and capable; and its admission to the WTO enables it to reap the benefits of globalization. If China continues to grow at breakneck speed, as it has so far, following the growth trajectory of other Asian nations such as Japan, South Korea and Taiwan, aggressive U.S.-China competition over oil will be almost certain. On the other hand, if for whatever reason China's economy will slow down, its high rates of energy consumption will decline and the resources problem will be somewhat mitigated.

The second predictor of future Sino-American relations is the ability of the world energy market to provide enough cheaply recoverable oil to satisfy global demand. Petroleum reserves are undoubtedly limited and there are only so many places to seek them. No one can precisely determine how much low-cost petroleum is stored in our planet. The world uses about 85 million barrels of oil per day. According to the International Energy Agency, this amount is projected to grow to 120 mbd by 2030. This means adding to the oil market four Saudi Arabias or twenty Nigerias worth of oil in just 25 years. I am doubtful that fulfilling such demand at reasonable prices is geologically feasible. For some years many geologists have been warning that the world's ability to produce oil is approaching its peak, meaning reaching the point in which half of the world's oil endowment is depleted. How far we are from peak production is a matter of intense debate. The U.S. Geological Survey (USGS) states that reserves of recoverable oil stand at about three trillion barrels and that peak production will not come for about 30 years. The International Energy Agency (IEA) believes that oil will peak between "2013 and 2037." But a growing number of geologists claim that peak production will arrive much sooner. For years, these "depletionists" have been warning that the huge "super fields" that supply most of the world's oil were discovered in the 1950s and 1960s and the recent oil discoveries have been significantly smaller. Even the industry's confidence in its ability to provide the market's needs is waning. "The time when we could count on cheap oil and even cheaper natural gas is clearly ending," Dave O'Reilly, chief executive of ChevronTexaco admitted recently. Surely a world awash with cheap oil will eliminate grounds for dispute among consumers, but it is less clear what will be the impact of shortage and high prices. On the one hand it could increase the likelihood of aggressive competition between the heavily dependent U.S. and other major consumers spearheaded by China. On the other hand, high oil prices are likely to slow down economic growth in China and the world at large and therefore reduce energy demand.

The third predictor of whether China and the U.S. are bound to clash over oil is the relationship between the two countries and OPEC members, especially in the eventuality that shortage does occur. When it comes to control over reserves the balance of power between OPEC and non-OPEC producers is tilting toward the former. Non-OPEC nations now pump close to two-thirds of the world's supply but in relation to their reserves their production rates are nearly twice as great as OPEC's. In other words, they produce far more than they discover. According to Exxon Mobil Corporation, non-OPEC production will start to decline within five years or so while OPEC producers will still be going strong. Consequently, OPEC's share of the pie will increase—and with it its control of the market—to over 90% of world oil reserves and over 60% of production in 2030. At this point, those countries with the strongest ties to OPEC members will enjoy a strategic edge.

While it is true that oil is a fungible commodity and its prices and supply levels are determined by the international markets, ownership of oil assets and good relations with the governments that own them give the consuming country considerable advantage. Nine of the world's top ten oil companies, together holding over 75% of

the world's oil reserves, are owned by governments, not publicly traded companies. If U.S. relations with major OPEC producers such as Saudi Arabia, Venezuela and Iran continue to deteriorate while China succeeds in courting them, OPEC's oil will be more readily available for the Chinese market while supply to the U.S. will be increasingly compromised.

Conclusion

Despite the many tell tale signs of China's oil-driven international behavior, Washington has not yet turned its focus to the implications of 1.3 billion Chinese gradually abandoning their bicycles for cars on U.S.-China relations. Neither U.S.' foreign policy nor its energy policy currently address the possibility that global demand might outstrip supply. The best demonstration of this complacency is the energy bill currently deliberated in Congress. The bill proposes a modest goal of reduction of U.S. oil dependence of 1 million barrels by 2015 while U.S. demand by this time is projected to grow by 4 million barrels per day. As a consumer of a quarter of the world's oil supply and holder of merely three percent of global reserves, the U.S. cannot afford to sit on its hands and hope that the world's energy problem resolves itself. In addition, with one of the worst fuel efficiency standards in the industrialized world the U.S. lacks the moral authority to preach to the Chinese about the need to address *their* oil problem. Nor can it ask them to deny their people the high standard of living that Americans have been enjoying for decades.

While there is an urgent need for a comprehensive energy strategy to deal with China's energy needs such strategy cannot be based on seeking ways to block China's access to oil. The U.S. should look inward and begin to seriously address its growing addiction to oil and more broadly assign a larger role for energy policy in its global strategy. This can only be done through multinational cooperation on energy and a joint commitment by the U.S., China and the other consuming countries to work toward reducing global oil dependence through efficiency and development of alternative energy sources. Both the U.S. and China are not rich in oil but they are both well endowed with a wealth of other energy sources that can be used to displace petroleum in the transportation sector, which accounts for two-thirds of U.S. oil consumption and the bulk of the growth in oil consumption in the developing world. Both China and the U.S. are rich in coal; both have large cities that generate huge amounts of garbage and both have massive agricultural sectors that generate billions of tons of biomass. Technology can convert all of these resources into transportation fuel. Were the U.S. and China to collaborate on advancing such technologies and improving efficiency they could gradually curb their demand for oil and hence reduce the likelihood for conflict.

Thank you, Mr. Chairman.

Cochair WESSEL. Thank you. Please.

**STATEMENT OF FAREED MOHAMEDI
CHIEF ECONOMIST, PFC ENERGY
SENIOR DIRECTOR, COUNTRY STRATEGIES GROUP**

Mr. MOHAMEDI. Mr. Chairman and the various Vice Chairmen, thank you for inviting me to address this important issue. What I'd like to do is put some perspective on the Chinese actions in terms of Unocal and possibly provide some solutions to it at the end of my talk.

To put China's energy-related activities in context, it is helpful to examine the forces driving the recent spate of moves made by China in this arena. In little more than a decade, China has gone from being a net exporter of crude oil to the world's third-largest importer of oil and is well on its way to surpassing Japan and becoming the second largest after the U.S.

China now imports about 3.5 million barrels of crude per day, and it's just about one-fourth of what the U.S. imports on a daily basis and its growing to the point whereby around 2020, we believe it will be around eight to nine million barrels a day. So it will be a major importer as you have noted earlier. The reason it is is because China is growing extremely rapidly and why China needs to

grow rapidly, at least seven percent growth per annum, is to maintain social political stability.

It is absolutely economics is the way for it to maintain its current political stability and over time possibly transform its system. How is it going to do that? It's going to do it through basically by attracting foreign investment and also reforming its state enterprises and key in the heart of the state enterprises are the state and national oil companies.

China has had to because of this rapid growth engineer radical shift in its energy policies. It has done so by focusing on a two-pronged strategy. One is retooling the domestic oil sector, primarily the national oil companies, and secondly pursuing strategic deals that some of you have noted with various large hydrocarbon producers.

The Chinese NOCs are a special type of state enterprise in China. They, number one, provide a strategic mineral and input into the industrialization process in China. But also they are huge employers of Chinese citizens and that has given them importance in the strategic sense.

In the last, let's say the last decade, the individual NOCs have been tasked to become fully integrated companies through technology acquisition and sectoral experience. Many of them were specialized in the old system. CNPC, for example, was largely an upstream company. Sinopec was largely a downstream company. Now they are being tasked to become totally integrated.

But the second thing that they have been tasked to do beyond these corporate changes is they have a new mandate, and that is to aggressively secure access to international resources, preferably by securing access rights to physical production. They are bent on buying actual and finding actual crude and gas resources.

And this is one of the reasons that they are going after Unocal, one of their NOCs is going after Unocal. But this is just one of many deals that they've done around the world in the last several years: an agreement with Iran, whereby the latter will provide access to gas resources which will be transported to China in the form of LNG; a major gas exploration deal with Saudi Arabia as was noted, a conclusion of an agreement with Exxon Mobil and Saudi Aramco for refining and petrochemical complex in Fujian; various deals with smaller African countries such as Equatorial Guinea and Gabon; and an agreement with Kazakhstan to build a crude oil pipeline to Western China.

What this shows us that China needs a variety of energy inputs, not only simply crude oil. Oil will remain the primary focus for the foreseeable future, but China is also eager to diversify its sources of supply. This is a very important strategy of the Chinese is firstly to concentrate on getting supplies from internal China which is proving difficult, then Asia itself, then Russia and Central Asia, then Middle East, and in fact the North American play mainly is concentrated on Canada because of heavy oil.

But this is coming at a particular and unnerving time for the Chinese because they're growing very rapidly but they're finding the more they look overseas there is less oil to find. And in fact it's concentrated in countries, for example, Saudi Arabia, where

they don't really have access to and they will never get access in my opinion to Saudi oil.

They may and they have to a certain extent to Saudi gas, but that's a different story. But the heavy reliance on the Middle East is unnerving them, too, firstly, because they perceive it as a volatile region and, secondly, they perceive it as under the preserve of the United States. So they are looking to find different sources, independent sources of crude oil and gas.

I think that in general this in a sense this insecurity, this worry that they're trying to access this oil and gas in a period of scarcity has driven them to a certain extent to rather unfortunate moves, and I think the Unocal one was unfortunate in that it is trying acquire a company, as was noted, with subsidized and in a sense an uncompetitive manner.

And that is, I think, brought it unnecessary attention. The issue, though, and I think that in the future it may serve China's objectives of getting access to energy better if it is more transparent and meets regulations around the world.

Yet, for all the troubling news that we've heard with Unocal, et cetera, the Chinese actions in the area of energy, most of China's actions are driven by real concerns that need to be addressed. If we are going to live in a globalized world, an integrated world, we have to find ways in a peaceful manner to work with China, and this I think raises some important issues of how the U.S. Government and other governments around the world will work with China to meet its energy needs.

It is a very important part of the world economy and will continue to grow in that sense, and if are not going to have disruptions there, then I think that energy, finding energy and helping China secure that energy is going to be an important part of our work in the future.

Thank you.

Panel II: Discussion, Questions and Answers

Cochair WESSEL. Thank you both for your testimony. Chairman D'Amato.

Chairman D'AMATO. Thank you, Mr. Chairman. I have a question for both of you. It seems to me that some of the projections your firm has made in terms of world supply and demand of oil, that in about 15 years or so, the world demand for oil will begin to exceed its supply.

Now, if present trends continue, if the Chinese continue to go after oil in the aggressive way that they're doing and we don't develop alternative supplies of energy in a substantial way, more supplies of alternative energies of all kinds, is there any way that we're going to be able to avoid collisions on this matter with the Chinese, and how do we get out of that if that's the case?

Dr. LUFT. I think it's a very appropriate question to ask at a time that a few rooms from here, not very far from where we are sitting, the Senate and Congress are deliberating the next energy bill, and one of the provisions in the energy bill is to take a national commitment by the United States to reduce its oil demand by one million barrels a day by 2015. It was killed.

So I think that before we look at China and what they do, we also need to take a deeper look at our energy policy and realize that we are not today in a position to lecture to the Chinese about their growing demand for oil when our energy policy does not address the issue of our own growing demand for oil and when our fuel efficiency is the worst today in the industrialized world.

Just to put things in perspective and I think that if we really want to become leaders on this issue and I agree with everything that you said, there is a serious concern, as presented by PFC Energy, but also excellent cooperation, and the latest report that non-OPEC reserves are likely to begin to decline within five to ten years from now, and I must add that it's important to notice that non-OPEC reserves are declining faster than OPEC reserves.

That means that the dependence on OPEC will be stronger as the years go by. That means that China's relations or our relations with OPEC will mean much more than they are today. It means that if you have better relations with OPEC countries, you probably are going to have some advantages down the line, and it is very critical to understand that when 75 percent of the world's oil reserves are in the hands of governments, primarily OPECs, the relations with the governments that own 75 percent of the world's oil will be critical.

What China is doing today, it is courting those governments and making sure that down the line, they will have these relations while our relation with these governments are continuing to deteriorate.

Chairman D'AMATO. Mr. Mohamedi.

Mr. MOHAMEDI. I'm pessimistic in the sense that we are heading towards shortages in the future, as our company has pointed out with our study. I am not so sure, though, that the OPEC countries will strike any preferential deals with Chinese companies. Why should—and this is the whole trend that's been taking place in the last few years of national oil companies from consuming countries, Brazil, as among them, the Chinese companies, the Indian ONGC, are all going out and trying to secure supplies all over the world.

It's really frightened the independent oil companies, the international oil companies, because not only now can they not access some of the areas that the national oil companies had blocked them but now they are finding that these companies are coming out and competing with them, and in some cases getting some state to state deals.

But I think in general the national oil companies that are venturing out will fail to get any real preferential deals. Why should Saudi Arabia, why should Kuwait or anyone share the rents anymore? They don't want to share it with the international oil companies. Why should their share it with the other national oil companies? Why not keep the rents for themselves? And so I don't think that is that worrisome.

I think the general energy situation will be a problem, and I think we really need to have a serious debate on that, but I don't think China will get any extra, have an extra angle into some of these countries now, with the exception of possibly where international oil companies are prevented from going in, in places like Iran where they are constantly under threat, et cetera.

Chairman D'AMATO. Thank you.

Cochair WESSEL. Commissioner Becker.

Commissioner BECKER. Thank you very much, Mr. Chairman. Chairman D'Amato covered some of the points that I wanted to cover. I don't want to be repetitive, but let me ask you just your opinion, Dr. Luft for sure, you talked about Canada and the oil tars. You can run down the list for many other things in Canada in natural resources that China has gone for the same way that it is with oil.

I've always viewed Canada as a sister country to the United States and one that there was an unbreakable bond between us. We have a free trade agreement with Mexico. There's been billions of dollars of foreign direct investment going into Mexico from the United States. I would think our relations were impeccable in Mexico or they should.

And you drop down in South America. I feel the same way about the South American countries that we've invested in, we've worked with all these years. Why do you think we're losing out in this race for oil? Why do you think these countries like Canada and Mexico and South America are going to China, cutting deals with China absent the United States?

What's going on that you feel that is happening in there? You can keep it with oil, but I think it goes far beyond oil?

Dr. LUFT. I will separate between two types of countries: developing countries and developed countries. I think that the Chinese have tremendous advantage vis-à-vis the developing world because they tend to tie their energy deals with a lot, a lot of development money.

When they come in, when their foreign minister or prime minister or president goes to a president like Gabon or Nigeria, any other country that is developing, at the same time that the energy companies are negotiating, there is a development package. They never tie it together. They always make sure to say that it's unrelated. But in a lot of those countries when you come in addition to the energy deal with a new transportation system, a new communication system, a new irrigation system, whatever, you build a new port, that sweetens the deal and it helps them get something that we cannot do because our companies cannot compete.

Exxon Corporation cannot give the same amount of development money that the Chinese do. In the developed world, we have other issues, and let me take the issue of Canada, for example. One of the reasons that—well, the Canadians are eager for investment. Everybody is looking for investment and the Chinese can come up with a lot of investment, but also we have to remember that one of the reasons that Canada has been so open and receptive to the Chinese bid is simply because we still have outstanding trade issues with Canada.

We're telling the Canadians don't deal with the Chinese. But we don't even want to buy their beef anymore. We have lumber issues with them so, you know, everything is tied. One of the reasons that I hear from Canadians is you know let's solve our outstanding trade issues before you tell us with whom to trade. So I don't think we can take for granted any of our relations within our backyards, not with Mexico, not with Venezuela.

So today Venezuela is still in a position that geographically and physically, they cannot export a lot of oil to China, but that will overcome, and I think we need to make sure that we keep this oil available to the U.S. market.

Commissioner BECKER. Not with Venezuela either, but not with Brazil, not with Chile, not with Peru, not with Argentina. We're going down the whole gamut. It's almost like we have our head in the sand on this, but let me switch to another thing unless you want to comment on that?

Mr. MOHAMEDI. Yes, I'd like to comment.

Commissioner BECKER. Mr. Mohamedi.

Mr. MOHAMEDI. I don't think that U.S. companies are not being able to effectively compete. We compete on many levels. Exxon Mobil's programs and Chevron Texaco and other companies are doing a very good job all over the world competing with their technology, et cetera, and their ability to access markets.

So I think that that may be slightly overblown. The second thing is on Canada, the issue was a more commercial issue, and in the case of Mexico, it's the Mexican government that hasn't allowed anybody to come in and invest in the sector, and I think that there the U.S. has a role to play in working with the Mexican government in opening up its oil and gas sector, mainly for its own sake, its own ability to access abundant and cheap resources.

Venezuela is an interesting case. Venezuela supplies the U.S. Venezuela has something like two million barrels a day of refining capacity in this country and is hard-wired to the United States by sending the crude oil to be refined here.

So I think that in that sense, the Chinese threat has been slightly overblown. But I think longer term, yes, it is an issue, especially in a world of scarcity, and that I think it would be better for us to find ways to work in this not only with the Chinese, but there is a whole Russian component to this and other countries to find a way so that we don't come to have resource wars and conflicts of the 19th century.

Commissioner BECKER. Go ahead.

Cochair WESSEL. We may be able to come back for a second round of questioning.

Commissioner BECKER. Yes.

Cochair WESSEL. Vice Chairman Commissioner Robinson.

Vice Chairman ROBINSON. Thank you, Mr. Chairman. We've had some discussion about the way China does business in the energy arena around the world and there was the observation that China may not receive preferences even though they're working these oil-producing governments very hard to achieve that kind of preference. Mr. Luft has pointed out that these development packages are no small matter, and even though they are ostensibly not tied to energy contracts and concessions, one would have to be very obscure indeed not to see those connections.

Mr. Mohamedi, you did acknowledge that in the sanctioned countries where U.S. oil firms are more or less prohibited from going, at least with the exception of their overseas subsidiaries, for example that China probably does have an advantage there? But isn't it the case that beyond development packages as an implicit tie or

benefit to its energy strategy that they also have the military insecurity side?

For example, Sinopec is obviously very big in Iran and would it surprise you to know that two of its subsidiaries have been charged with proliferation of chemical weapons and have been fined for so doing?

That raises the question in my mind—was that in the risk section of the prospectus when Sinopec went for its IPO in June of 2000 for \$3.4 billion from American firefighters, police officers, pension fund holders and the like?

I don't have a ready answer to that question, but I think the answer is likely to be no. We don't sanction parent companies of proliferators, only the subs. I think the fact that Sinopec is such a larger energy concern—maybe the second-largest in China—the fact that it has proliferators as subsidiaries, isn't there a message there that when you're dealing with terrorist sponsoring states in particular, that it's not a matter just of roads and bridges and infrastructure projects, but it's also a matter of components for ballistic missiles, chemical/biological weapons, all kinds of dual-use equipment and technology, that is part of the big package, the security, infrastructure, et al., package that accompanies a Chinese bid? CNOOC was a very narrow example, but nevertheless it was a hell of a wake-up call on this very issue, at least with subsidies.

But you throw in what a Sinopec looks at or a China National Petroleum Corp. looks like in a place like Sudan, it makes the CNOOC subsidies look trivial. What's your observation on those points, both of you?

Mr. MOHAMEDI. I agree with you. I think it's troubling that these sorts of activities go on. No one would like to see the proliferation of weapons of mass destruction around the world, and I think that if these companies are party to that, I think that they should be dealt with given the appropriate regulations and all of that.

I think, though, this is just part and parcel in general of how the world works with energy and accessing energy. I think that the United States does some of this in terms of aid to countries that are producing oil. When we created a strategic tie with Qatar, and we built a huge military base there, and it was part of our war on Iraq, and we provided lots of credits, et cetera. France does this when it goes into countries. The UK does this.

So I think that on an economic level, this is par for the course. A lot of countries have done that. And you'll see the Indians doing that, et cetera, because there is this sense of scarcity out there, there's a sense of we need the resources to develop our country. So I think we have to deal with some of those issues. I agree there are issues of concern, but in a broader sense, this whole issue of energy security is going to rear its head, and it's going to be something we have to deal with, possibly by conservation, possibly by funding other technologies. So I think you've raised a very good point in terms of the future.

Vice Chairman ROBINSON. There's a little bit of moral equivalency in those comparisons, though, that may not be.

Mr. MOHAMEDI. I'm sorry. I wasn't making any moral. I separated out the activities on weapons of mass destruction, but I was

quite specific in saying that the pursuit of economic development is quite consistent around the world. Many countries do that.

Cochair WESSEL. Commissioner Mulloy.

Commissioner MULLOY. Thank you, Dr. Luft and Mr. Mohamedi. This Commission and I have been pretty outspoken on the CNOOC transaction. I was asked by a Chinese reporter why are you so opposed to this commercial transaction? I said precisely because it's not a commercial transaction. The largest shareholder in CNOOC withdrew and sold its shares because they made the same conclusion. So they were worried about that.

We've taken a pretty strong view on that. At the same time, I note your point about the commercial transactions going on in Canada, that the Canadian resources minister has now said there's a difference between a government-owned enterprise and another. They've asked for new legislation to be able to stop transactions, what they would not consider in their national security interests.

But while we've taken a pretty strong line on CNOOC, we also have strongly recommended that somehow China be brought into this IEA oil-sharing mechanism so that we're all not out there bidding in times of shortages. We've voiced concerns about the Chinese strategy of getting oil at the wellhead and taking it back to China.

I think that's the area that we need to make some positive initiatives. Dr. Luft, I note that at the end of your testimony you talk about working technologies, coal, garbage and other things, turn those into energy. So I would look for your views on what specific things would you think we ought to recommend to the Congress?

I can understand China might have energy insecurities. So what should we do? I don't want this to be an area of conflict. I think it needn't be. What are your specific recommendations for us to make to the Congress in that area?

Dr. LUFT. First of all, we have a lot of similarities with China in the sense that both the United States and China have similar energy endowments. The United States and China are both rich in coal. They're both rich in biomass. They're both rich in garbage, cities that produce a lot of that. And they are both poor in oil. And I think that these kind of technologies can be, especially in the field of clean coal technologies, in the field of biomass conversion, because those two technologies allow you to address the issue of transportation, which in the United States, two-thirds of our oil is being used in the transportation sector, so that's the big bear to kill.

I think that as China's automobile fleet is growing, they will have stronger and stronger incentive to invest in building automobiles that run on alternative fuels and that are fuel-efficient cars. So that is one thing that we need to be very aware of, that there is tremendous potential in these fields. China is the Saudi Arabia of biomass. We're talking about a country where 80 percent of the country is still rural. Those farmers generate agricultural waste that can be converted into fuel using new technologies that are becoming increasingly available today.

China is very interested in converting its coal to fuel. They are looking at the South African sassal, technologies of coal liquefaction, and also other technologies with regards to natural gas.

The last thing I would say is because China's electricity sector is growing and China is interested in building nuclear reactors, this is something that both the United States and China should cooperate in the sense of beginning to electrify the transportation sector. In other words, using more electricity as a fuel because in both countries, electricity can be produced domestically from whatever makes sense, nuclear included, but also solar, wind, whatever. I'm not going to get into how you make the electricity, but you can tap into electricity sector and use it for transportation in the way that you displace oil.

What you need to do is to increase cooperation and make sure that our industries are not being compromised by this process, that the Chinese will take the patents, run with them, and we'll be sitting on our hands because Detroit doesn't want to make those cars. That's a big issue, but I think Detroit will get a wake-up call when you can buy a \$5,000 car at Wal-Mart from China unless they get decimated before that.

My feeling is that they will cry for a government bailout when they realize they cannot compete with the Chinese, but this is a very, very important issue that has to do with the Chinese automobile industry and China today is the fourth largest manufacturer of cars and it's going to surpass Japan and Germany within a decade. What does it mean for our auto industry is a topic for another day.

Commissioner MULLOY. Mr. Mohamedi, do you have anything to offer?

Mr. MOHAMEDI. No, I think it's been said quite well.

Commissioner MULLOY. You would endorse what he had to say?

Mr. MOHAMEDI. Yes.

Commissioner MULLOY. Thank you.

Cochair WESSEL. Commissioner Donnelly.

Commissioner DONNELLY. Thank you both, particularly it's nice to see Dr. Luft excelling so well in his recent work. I'd like to sort of tie together a number of themes and maybe amplify upon them.

It seems to me that really it's not so much that China is using political and other means of influence to gain economic advantage or even energy security per se, but rather than it's using to ape the phrase used in the Pentagon, "all means of national power to achieve its geopolitical and strategic ends."

So it's rather the political effects of its energy policies which are the things that are of greatest value to Beijing and make the premiums that they pay for acquisitions like Unocal attractive to them. And in that regard, I'd like to get some help from the witnesses to help me understand what seems to me, doing some homework on this, that Unocal, although a relatively small player in an international sense, is a disproportionately large influence in important places like Indonesia, even in places like the Caspian and Azerbaijan, which is arguably the United States most even closest or sole strategic partner in the Caspian, and also disturbing to East Asia will be the fact that if CNOOC acquires Unocal's facility in Indonesia, its LNG facility, that those supplies are critical supplies for Korea, Japan and Taiwan in particular which gets something like 50 or 60 percent of its LNG from that one source in Indonesia owned by Unocal.

And, of course, Unocal is a huge presence in Indonesia which is, as everybody knows, a strategically vital state in Southeast Asia, so what I would like you to do is to cast aside the sort of macro-economic analysis of this acquisition and look at it entirely through political prism and try to analyze it that way.

And the second task is to try to in your own mind sort of aggregate all the various agencies of the Chinese government's energy policies, Sinopec, CNOOC, PetroChina, et cetera, et cetera, which I think we must have, must regard largely as coordinated if not a single arm of the Chinese government and give me your assessment of how these various state-owned enterprises combine together to represent Chinese strategic interests in energy markets.

So if you've got a couple paragraphs on each one of those subjects in you, that would be very useful to me.

Mr. MOHAMEDI. Should I start?

Commissioner DONNELLY. In whatever order works for you.

Mr. MOHAMEDI. The irony of this purchase, which I think we as a company have felt that the means that they have pursued, the subsidized loans and all that, in a sense is uncompetitive and it's unfortunate, but the irony is that this type of strategy will not really help China achieve its energy needs. Its ability to get sufficient—it will not be able to find eight million barrels a day by 2010 and capture those and physically bring them over. There is nothing out there that it can do.

Commissioner DONNELLY. So maybe there's another explanation as to why they're doing this. If it's economically—

Mr. MOHAMEDI. The policy, and I think that this has been well documented, is that the Chinese have set their, what do they call it, their NOCs, the national oil companies free, and said go out and for national, for national security reasons, but do it in a competitive way and we'll support you, but go out and compete for resources out there with other national oil companies, with other international oil companies.

And actually to a certainly extent, they're competing with themselves to go out and get it. So they're acting as commercial companies with a lot of help from home. All right. So in a way, the means are to a certain extent decentralized, where they're going out and they're trying. Now when they find a deal, then they go back home and say, okay, can I have some money and support me on that.

All right. But I think that all of this flurry of activity and all this subsidized loans and all of that will actually lead to very few barrels in the end and actually there will be a time when China like Japan—Japan, by the way, pursued some of this similar policy back a few years ago and then finally abandoned it because they realized they had gotten a few thousand barrels for \$50 billion, and the question in the industry is whether in ten years, that they come home and say, wow, we've just blown \$50 billion and not gotten 50,000 barrels.

And I think to a certain extent that's what is going to happen. That doesn't negate the fact that the means are unfortunate, and I think that message should be sent on that front.

Commissioner DONNELLY. I guess what I'm trying to get you to focus on is the ends. And suggest that if extraordinary economic

means are being used that perhaps there's a purpose to this that's beyond economics as well.

So that's kind of—

Mr. MOHAMEDI. Oh, I think energy is a very political mineral, and you're right, and in our thinking, all countries pursue energy security as a critical geopolitical objective.

Commissioner DONNELLY. Gal, have you got a comment?

Dr. LUFT. I see where you're going. I think I've got the general direction because I was looking at all the countries that Unocal has some acquisition. I'm only talking about geopolitics now.

The two interesting places are Thailand and Myanmar, Burma. Those two countries are important for China in the sense that—particularly Thailand because China is trying to find ways to ship oil and circumvent the Strait of Malacca. That is a major strategic concern for the Chinese, the fact that this bottleneck, this chokepoint through which so much energy bound for Asia is going through.

Thailand could create/provide a critical support for the Chinese in trying to divert some of the traffic that goes through the Strait of Malacca to various energy projects, pipelines, and perhaps even something even bigger that could come down the line.

So I think that they have an interest in strengthening their presence in Thailand. Burma/Myanmar same thing. They are very interested in building pipelines that go through this part of the world, so I would say that from purely geopolitical output, these are the places that they would derive most of the geopolitical benefit.

Commissioner DONNELLY. Thank you.

Chairman D'AMATO. Commissioner Bryen.

Commissioner BRYEN. Thank both of you for your testimony. I want to ask some questions of Mr. Mohamedi since he raised some interesting issues in his testimony that I think we have missed.

You're talking about the Chinese requirement to sustain current levels of growth at you mentioned seven percent growth, going from 3.5 million barrels a day imports—is that correct?—

Mr. MOHAMEDI. That's right.

Commissioner BRYEN. —to eight to nine million barrels a day imports by 2020 or 15 years, roughly 15 year period from now. Is that extra—assuming everyone else holds steady and level, which is an assumption—I don't know how valid that is because we seem to increase. But assuming that everything else holds level, is that extra five million barrels a day out there to get? Is it technically available?

Mr. MOHAMEDI. We produce, the world produces something like 82, 83 million barrels a day right now. By 2020, I think we were saying that the world most likely will not be able to produce more than a hundred, so if we've got about 15, 15 to 18 million barrels a day extra coming on line. We expect that that will happen. So in a sense, this could be accommodated over this period.

Commissioner BRYEN. Provided there is not too much growth elsewhere.

Mr. MOHAMEDI. Right.

Commissioner BRYEN. Yes. But if there is growth elsewhere?

Mr. MOHAMEDI. We think that if growth is around about—and this is a conservative number—around two percent per annum, that by pretty much close to that period, demand will be around 100 million, and that we will not—the supplies will—and that was our study—that supplies will not be totally able to accommodate. So there will be around that time, plus or minus a few years, and it's very difficult.

As you know, we economic forecasters give astrologers a bad name.

Commissioner BRYEN. Right.

Mr. MOHAMEDI. But around that time, we feel that there will be a problem on a global scale.

Commissioner BRYEN. Okay. So it's a tricky period that we're entering into.

Mr. MOHAMEDI. Right.

Commissioner BRYEN. And, of course, these assumptions all assume no disruption?

Mr. MOHAMEDI. Absolutely, yes.

Commissioner BRYEN. So if there is one bad event in the Middle East, for example—

Mr. MOHAMEDI. Exactly.

Commissioner BRYEN. —then we're all in trouble.

Mr. MOHAMEDI. At this particular point, and this is why oil markets are so tight and so jittery and nervous and why we have these high prices, is that we have an excess capacity, mainly concentrated in Saudi Arabia and the Persian Gulf, of around two, 2.5 million barrels. So if a country producing about three million barrels a day goes offline, we cannot offset it with a surge in Gulf production.

Commissioner BRYEN. Precisely.

Mr. MOHAMEDI. This is why, and we're going to have this problem despite the fact that the Saudis have agreed to increase their capacity from around 10.5 to 11 million barrels a day to 15 million barrels a day, which is what I think will happen definitely.

Commissioner BRYEN. Now you also said that this seven percent, which was the other intriguing part of what you were talking about, that this seven percent growth is vital to Chinese stability, political and economic stability; is that correct?

Mr. MOHAMEDI. Yes, absolutely.

Commissioner BRYEN. What happens if they fall below that target?

Mr. MOHAMEDI. Well, I think that they will not be able to meet some of their employment needs, which causes political instability domestically. This is from our reading of the situation.

Commissioner BRYEN. So, in effect, to take one cut at this, and we could say that unless we help China sustain this kind of growth, there is a chance China can become highly volatile, destabilized and problems can arise. It's a kind of trap, isn't it, that we're in?

Mr. MOHAMEDI. Well, the world economy now runs on two pistons: one, the U.S. economy and one the Chinese economy.

Commissioner BRYEN. Right.

Mr. MOHAMEDI. And they are very much intertwined. As a macroeconomist, you run huge budget deficits, it boosts demand,

you're consuming more than you're producing, you import goods; China is set up to export goods to us. And so we are just in this loop. And then they buy our Treasury bills, keep interest rates low, so the economy continues to chug along, and so we've got this, in a way, this circle going of self-perpetuating growth.

Now, the key question is, and this is the whole issue with the currency and all of that, is when does China stop buying those bonds and interest rates rise and growth slows down, and then Chinese growth slows down? And we think some of that dynamic will take place over the next several years, and that could slow oil demand growth both here and in China.

Commissioner BRYEN. Or it could cause unrest in China.

Mr. MOHAMEDI. Possibly, yes.

Commissioner BRYEN. And therefore major problems for everyone.

Mr. MOHAMEDI. Right.

Commissioner BRYEN. I think it's a very intriguing scenario that you've given us and one that the Commission is going to have to take into account in its evaluation. It's very helpful and I appreciate very much your testimony and both of your testimonies.

Thank you.

Cochair WESSEL. Thank you. Could I ask just a followup on Commissioner Bryen's question. Under that scenario looking out after the 100 million level, what's the clearing price do you estimate? Are we coming down from \$60 a barrel? Or are we looking at higher levels?

Mr. MOHAMEDI. That depends on year to year because if you have a slowdown, we aren't going to see in the next few years some new oil coming from areas like West Africa, Brazil, et cetera, and so that could lead to a faster acceleration of non-OPEC supplies. It could be the last hurrah for non-OPEC supplies before they go into a decline.

If we have a slowdown in the economy, we may have a little bit more of a looser situation in the oil markets. But in general I would say that we are now in a new sort of paradigm shift in terms of oil prices, and that 40 plus dollar oil is not difficult to see going out.

So with disruptions, et cetera, you could see quite easily 70 plus.

Cochair WESSEL. Let me turn, if I could, to a definitional question. Mr. Mohamedi, you laced your answers a couple minutes ago that China is doing this for national security reasons, and they are commercial companies with a lot of help from home, I think was your comment.

As you look at the debate about the CNOOC Unocal bid, is any reasonable economist suggesting that oil is not a national security asset?

Mr. MOHAMEDI. No.

Cochair WESSEL. Okay. Well it seems that you have given an easier answer than our own Administration which I hate to say chose not to participate in our hearing today because I think they're simply hoping that this issue will go away and that Chevron's more attractive bid will end the problem. From all that I've heard from the two of you that Unocal issue is just sort of the tip

of the iceberg as we look forward to China's energy acquisition strategies.

As we look the Chinese state-owned companies or state-invested enterprises, are they more than front companies? This seems to me to be intertwined with Chinese political strategies as I think you said and that we can't separate the two, that you have to look at what their energy companies are doing as really a function of government policy. Could you both comment on that?

Dr. LUFT. I think that they are to a large extent a front for the Chinese government. However, I think that we cannot lump them all together. We found some nuances and differences between some of them in terms of the management, the style of management, the education of the executives, the level of transparency.

There are some nuances there, but beyond all those nuances, the bottom line is that they are at the service of the Chinese government. They are beholden to the Chinese government, and they will execute the orders of the Chinese government.

Cochair WESSEL. Mr. Mohamedi.

Mr. MOHAMEDI. Absolutely. I think that, for example, NOCs are directed by the State Council, and the State Council is the equivalent of the cabinet. And the State Council members, some of them are ex-NOC CEOs and current NOC CEOs come from the State Council. So there is a definite tie between, direct tie between the state and these companies.

Having said that, these companies have been empowered both through state subsidies and through management and structural organizational changes to go out and compete and get this physical crude.

I do think, though, as I said earlier on, that in the end they will fail; they will waste a lot of money doing this. But it's concerning when it comes to disrupting commercial transactions like we see in the Chevron Unocal issue.

Cochair WESSEL. Let me understand also if I can the acquisition and the sales strategy if you will. I've never seen our independent oil companies reluctant to sell oil to the highest bidder. Should we look at CNOOC or any of the other Chinese owned oil companies as their acquisition strategy that if they get into a shortage situation, they want to own energy at the wellhead and capture that? They're not selling it on the open market; they are primarily bringing it home. They may be servicing markets that they're presently in, but in the long term, they want to ensure their supplies through ownership, not participate as market economies do in terms of open transactions? Is that correct or how should we look at that?

Dr. LUFT. I think you have a very good case study of comparison if you look, for example, at India. People talk a lot about China, but one billion people also need a lot of oil in India, and their energy companies are also going around the globe looking for their own acquisitions. But I think it's interesting to see the difference within the Indian acquisitions and the Chinese, and I think perhaps it's something more cultural, something that is more imbedded in the Chinese culture wanting to own something rather than participate in ownership or invest the way that we do.

But that all depends on what will be in the future. If indeed there will be more and more political instability, more and more

shortage and more and more relevance, stronger relevance for the physical acquisition, then those deals that the Chinese are cutting today may not be so illogical from economics point of view as some of the economists believe today.

Cochair WESSEL. Commissioner Dreyer.

Cochair TEUFEL DREYER. My question is for Dr. Luft. I completely agree with you that the United States needs to do something to increase its energy effectiveness, but it's also appropriate to point out that China's fuel efficiency is far worse than that of the United States. It also includes water wastage and huge wastage of other things. Chinese economists themselves have pointed out that they could reduce their dependence on imported oil by a substantial amount if they only cleaned up their own act literally.

My question relates to the several very interesting alternate sources of energy production that you mentioned: biomass from animal waste, solar, hydropower, and nuclear, et cetera. I wonder what your assessment is of the likelihood that these are going to work to give China sustainable development because if you listen to what Chinese technical specialists are saying to each other, they don't sound very optimistic. For example, they point out that the population continues to grow, which will mean the economy needs to grow to absorb the millions of new people coming on the job market each year.

The hydropower projects that they've come up with have been very hard on the environment. There are many of landslides and dams collapsing and so on. What is your assessment of the likelihood that this can actually work against China's sustainable development? Is there a breaking point somewhere in the future?

Dr. LUFT. I would focus my answer on petroleum substitutes rather than other more broader forms of energy because if we're dealing with oil, we need to look at things that can replace or displace oil rather than things that are beyond the range of broader issues like global warming and all this.

The beauty about China is that unlike the United States, which is completely beholden to almost 100 years of oil—we have multi-billion dollars investment in oil infrastructure, we have a very strong environmental lobby, we have an oil lobby, we have all these—the Chinese don't have all that. They are at the beginning of their growth. They can make decisions. If they believe that it's not a wise idea to go with oil, they might be more open to go into the next phase or to leapfrog oil and move into the next energy regime that is bound to happen anyway sometime in this century.

They are very interested in going there. They are investing a lot of money in the building. They have the largest ethanol plants in the world today; they are investing in battery technologies. They are leaders in this field of electric drive. I think that the Olympics in 2008, my understanding that Beijing will be the first "green city," that they want to really demonstrate to the rest of the world. That they have the largest fleet of natural gas buses. They are investing in methanol production today, and they have the largest fleet of methanol automobiles today and methanol can be made from coal and biomass and all these things, very cheaply, by the way, less than 50 cents per gallon. Highly recommend to do it the same in the United States, but—

I think that they understand that they need a lot of oil today, but they also understand that if there is a problem with oil, they want to have the lead in the next phase, and that raises questions about our competitiveness here. Are we losing our competitiveness edge? Are we going to wake up one day to realize that the Chinese have moved forward towards the next energy regime while we were sitting on our hands and did not do the right things?

Cochair TEUFEL DREYER. Perhaps we can compare notes after the 2008 Olympics. In Beijing when Chirac was visiting, the air show scheduled in his honor had to be called off because the pollution was so bad the planes couldn't take off. So, so far the major achievement of efforts to make Beijing a green city has been to die the grass green when the Olympic Committee came to inspect the area—in January. So let's see what happens in 2008.

Cochair WESSEL. Commissioner Bartholomew.

Cochair BARTHOLOMEW. Thank you very much, Mr. Vice Cochairman. I think we should just make everybody a Deputy Assistant Chairman and we can dispense with all of our titles.

Thank you to all of our witnesses. Your testimony was very interesting. A couple of observations. I'm trying to come to terms with some of the same issues that Commissioner Donnelly is trying to come to terms with, which is what else might be going on here?

We understand the importance, the primacy of the search for oil resources, but what other agendas are being carried out at the same time? The observations, particularly, Mr. Mohamedi, on the nature of CNOOC and these state owned oil companies or state majority-owned oil companies, I found it particularly interesting that the most recent appointed to the CNOOC board was the Director of Ideology Affairs at CNOOC. Interestingly, he replaced the former Swiss ambassador who purportedly stepped down because he didn't believe that the bid should have gone forward on Unocal. To remind everybody in the audience that the sole function of Department of Ideology Affairs, of course, is to make sure that people stay faithful to the party line. I think it's a rather unusual board position to have. That's one thing.

The second point that is particularly interesting is that the majority of Unocal's holdings in Asia are liquefied natural gas and, of course, in the PRC, the price of liquefied natural gas is state controlled. So you end up with this interesting dynamic of what some people were calling a free market transaction, but it would have been a 70 percent government controlled company receiving \$7 billion in subsidies to purchase a raw material that is traded domestically under centrally-dictated controls. So this gets to the question of where is the free market in there?

The news reports are indicating that the deal is over, but I have a feeling we are going to see other things happening between now and August 10 when the shareholders actually move forward.

I was particularly interested, Mr. Mohamedi and Dr. Luft, that in some ways you each had a different vision of China's future role in the Middle East. I'm curious in terms of Saudi Arabia and how you see it potentially playing out, particularly because I think that one of the issues that we've seen in the developing, not calling Saudi Arabia, but in the developing world, there are these incentives that as people move forward, there are the incentives of pro-

viding stadium, roads, whatever it is, in the form of development assistance.

It seems to me one of the other things that the Chinese government does in these transactions, is it does not put conditions on governance, which is an issue obviously of major importance in the United States. I wonder as I play through a Saudi scenario in my own head whether it might not be that the Saudi rulers decide at some point that they're kind of tired of this pressure for reform and the Chinese aren't going to be putting any of those kinds of pressures on them, so where is the disincentive for them go with the Chinese and just any thoughts you might have on that?

Dr. LUFT. I think you've touched exactly on the issue of why it is so convenient for the Saudis to work with the Chinese, because unlike us they don't get lectures about human rights, they don't get lectured about political reform; give us oil, here is money, end of story. That is very appealing.

Cochair TEUFEL DREYER. Very capitalist.

Dr. LUFT. That's how it works. Now, I think with regards to the Middle East, the key issue here, Middle East is in the balance today. What will be the Middle East ten years from now? Are we going to see a deterioration of the relations between the United States, Europe and the Muslim world? All these issues are critical here.

They go beyond economics. It goes back to Tom's comment. Sometimes, as we've seen in 1973, geopolitics, politics trumps pure economic decisions, and sometimes, especially in this part of the world, countries miscalculate and they make decisions that are contrary to their self-interest. We should not assume that they will always do the right things, especially when there is so much emotion, so much passion, so much religion involved in this.

I think that from a Chinese standpoint, it is I believe in their interest to see a further deterioration in the relations between the United States and some of its key allies in the Middle East because that enables them to move directly into this fissure and solidify their relations with those regimes as our relations with them deteriorate.

Cochair BARTHOLOMEW. Mr. Mohamedi.

Mr. MOHAMEDI. May I put it a little bit in a wider context? Relations between the United States and Saudi Arabia have been changing since the mid-1990s. In fact, that's part of the reason why we do have higher oil prices, and they actually started, attempts by the Saudis to, in a sense, favor higher prices started in the mid-'90s.

It accelerated after 2001 partly because of deterioration in relations with the United States over 9/11. But the Saudis have wanted to create, not break relations obviously with the United States, but normalize it. They had felt that they were just too close, that every time the call came from Washington, that the Saudis would jump and do something. They didn't want to do that anymore.

They wanted to pursue a more independent oil policy, economics policy, geostrategic policy. They started to diversify their relations, not only with China, but also with Europe, with Russia. You saw Crown Prince Abdullah's visit to Russia. So it's been a global policy.

Now, I think that having said all that, as I said earlier, there is no special access that the Chinese will gain in Saudi Arabia for its oil. The Saudis are not going to give up the rents to the Chinese like they're not going to give it up to Exxon Mobil, like they're not going to give it up to anybody else. Now, in the area of gas, they felt that's a much more economic fuel and that they don't want to put their money into that; they're going to concentrate on putting it into oil.

It's going to cost them \$50 billion, by the way, to get capacity up to 15 million barrels. So that they're going to have foreign companies come in. There is geopolitical element to that. In fact, if you notice, that there were four out of the five Security Council countries represented in the last gas deal, and it's interesting, and they also had quite a European presence because Saudi Arabia wants to tie in much closer with Europe, but in general, the relationship between China and Saudi Arabia mainly because the Saudis wanting to keep a good relationship with the United States and not destabilize that further, and the Chinese being worried that if they go into the Gulf in a big way, that will spook the Americans and so the combination is that they are keeping that relationship largely commercial. And this, I think, is a delicate game that's going on right now.

Now with Iran, the Chinese feel because it's a sanctioned company, there's an opportunity there, and that Iran is very much independent from the United States, but the other thing is that Iran has the second-largest reserves of gas in the world. So it will get some gas from Russia and it will get some gas from Iran. And Iran being in a troubled situation, sanctioned and all of that, the Chinese can drive a very hard bargain. They can say where else are you going to—who else are you going to sell it to? You're going to have to sell it to us. There's a little bit of commercial and geopolitics going on there, too.

Cochair WESSEL. Commissioner D'Amato.

Chairman D'AMATO. Thank you very much, Mr. Chairman. I would like to point out that the Commission did invite the Administration to testify today, but the Administration decided they didn't want to preempt the House Energy Committee, so they said we can't testify before the Commission; we're going to be testifying before the House Energy Committee tomorrow. Now, they've cancelled that, so we do not have any presentation by the Administration on the record on this matter. I think that's very unfortunate because it is a national security matter.

I guess the only thing I can say is that in Europe, they go on vacation all of August, and the Administration may think it's already August. In any case, here's my question. A lot of Commissioners have talked about alternative energy systems. Now, China does not have a mature oil infrastructure throughout its economy. We do. We're kind of stuck in the mud. We've got the whole thing loaded up with an oil infrastructure. They don't. So the opportunity is available for the Chinese to go another way, and if I look at the numbers we've been talking about, certainly 20 years from now we're going to be in a crunch period, but 30 years from now it's going to be impossible for us to have an oil-based international economy that works.

That's pretty clear it seems to us unless these reserves are all underestimated by large amounts which—we have to assume they're not. The question now is the Chinese have an immature infrastructure; they're going, for example, directly to cell phones and not laying all the landlines for telephones. Same thing here. Why not go directly to alternative energy systems, biomass and what have you, and bypass the building of a big oil infrastructure.

Now how would you evaluate this? Where are the Chinese on this? How would you evaluate their effort on this on say a one to ten scale?

Dr. LUFT. Mr. Chairman, I think that what we are about to see in the next probably 20 years is a Chinese Sputnik. They will move fast on this track. They will continue to invest in oil. They need a lot of oil. No matter what you do, you're always going to need oil.

As long as this cup is made from oil, the toys that you buy your kids for Christmas are made from oil. There will always be a need for oil. I think that the main thrust will be in the transportation sector and that is something that they can do today with existing technologies, and they are investing in the right technologies, they are qualifying a huge number of engineers. They have research institutions that are looking into this. I think that they are very advanced in their thinking because, as you said, they understand that there is a chance they will have to leapfrog and move into the next phase rather than stay with oil and have to go through this fierce competition over access to oil.

Chairman D'AMATO. On a one to ten scale?

Dr. LUFT. In terms of intention and will, I think that they're probably an eight. In terms of capabilities, they're still about a five. But they're moving fast.

Mr. MOHAMEDI. I think there are many countries like Japan and the Europeans that are hoping that they do start instituting, for example, in the transport area, some up-front, like, for example, up-front policies, for example. You can't invest anything but hybrid car technology. If you're going to invest in our auto industry then just invest in hybrids, and if that sort of cycle happens, then I think that there are a lot of countries like Japan and the European countries that could take advantage. Their automakers could take advantage of that, and I think they have a unique opportunity to up-front change and divert course, as you said.

I think some of that will happen just like your cell phone example.

Chairman D'AMATO. Thank you very much. I think that certainly is the one bright spot in this entire picture is the possibility that they will move aggressively in an area where the United States should have decades ago, but didn't. Thank you.

Cochair WESSEL. Commissioner Mulloy?

Commissioner MULLOY. Thank you again to our witnesses. You've been very, very helpful to us. I want to salute Commissioner Bryen for the questions that he was asking. Here's the way I understand it, what you told him. The Party in China which runs the country does not have legitimacy on the ideology anymore and their legitimacy is based on producing the economic growth, that to do this they have to have an export-led growth or running an export-

led growth. They're bringing in American investment, foreign investment. 60 percent of their exports are by foreign-invested companies.

They intervene in currency markets to keep their currency lower so that they continue to get the export advantage and encourage the foreign investment going in.

Of course, in the long run that leads us—and then they now have the money to go on an acquisition program like they can buy Unocal because they have all these dollars earned which they've been investing in U.S. Government to help keep our interest rates down, to help keep us consuming, so I think that was pretty good picture to point out to us.

Now, you both clearly said oil is a strategic commodity. You both said this is not a commercial transaction. But Dr. Luft, you pointed out the Economist, the Wall Street Journal, Newsweek, have all said the concerns here in Washington are over the top or, misguided. Then I see the head of Exxon Mobil making announcements that this is all misguided and that we shouldn't be interfering with market forces when they're clearly not market forces.

We've had a lot of other corporate leaders in America making statements of one sort or another that these concerns are misguided. Why do you think our corporate leaders are taking this kind of perception of this reality and trying to kind of muddy up what is really going on here?

Mr. MOHAMEDI. Well, it's very simple and it goes back into what Chairman D'Amato raised, the reason that you don't have the Administration weighing here because they are torn between two largest energy companies. On the one hand, you have Exxon Corporation saying to the Administration don't interfere. Well, now we know why. Because when they go into China and they have a huge energy deal in the making, the last thing they need is retribution.

Retribution is the name of the game here. You don't want to rock the boat because there will be repercussions here. The Chinese have a lot of leverage over our companies that are trying to go into China. On the other hand, you have Chevron Texaco. So if you are the Administration and you're torn between Exxon and Chevron Texaco, your only option is to sit quiet and not interfere.

Commissioner MULLOY. But are Exxon and Chevron, are they buying controlling interests in Chinese companies, oil companies, or are they assisting them? In other words, CNOOC would have a controlling interest in Unocal. Are our corporations buying controlling interests in what the Chinese call pillar industries?

Mr. MOHAMEDI. No, they don't buy. No, they invest. They invest. The Chinese limit the level of foreign investment. I believe it's 25 percent and that's how high you can get in.

Commissioner MULLOY. So, let me understand this. I saw that they've now put out a circular that no foreign companies can buy Chinese steel companies. They did say that they would welcome joint ventures if you have an important technology that you want to bring in. In other words, you can come, invest in our steel companies if you can help us be more productive, but we're going to control it.

Now, again, that's their business because there are no international rules governing investment for the most part. But it seems

to me that our corporations who are trying to advance in China are not really getting controlling interests, they're helping China build its industrial base and they're muddying the water back here as to what is really going on.

Do you both accept that premise that I've just thrown out there?

Dr. LUFT. They want to get in because it's a very lucrative market and they can get in up to 25 percent, which is for them is very, very appealing. So they'd rather have 25 percent or less, definitely not more, and produce the commercial benefits out of this to their shareholders and therefore they would like to see the system continuing as it is. But they don't have the broader view, the type of thing that you'd expect to see coming out of Washington. So we're dealing with a very narrow view of some of those businesses, and I don't blame them.

Commissioner MULLOY. Mr. Mohamedi, do you accept that the commercial, they may be looking at their narrow commercial interests, but they're not looking at the national interest, and somebody here ought to be looking at the national interest?

Mr. MOHAMEDI. I think that they're definitely looking after their commercial interests obviously and they're good at that. But I think that oil companies are very wary of in a sense coming together because they've always been accused historically of colluding. So I think that they—and this clearly shows—that there's a lot of diversity of view in the industry, and they are competing against each other on many levels.

But I don't know what the individual motivations of statements from different companies—I haven't studied them.

Commissioner MULLOY. I do note that part of CNOOC's effort was not just the hiring lawyers and investment bankers, but also a PR firm to work the media in this country, but thank you.

Co-chair WESSEL. Commissioner Donnelly.

Commissioner DONNELLY. Thank you, Mr. Chairman and all the Chairmen. I aspire to be a Chairman myself one day.

Chairman D'AMATO. You will. You will.

Commissioner DONNELLY. Okay. All in good time. One editorial comment before I return to the political questions I tried to raise earlier. And that would be the thing that I almost fear most is China relieved of the sense of vulnerability that comes with its dependence on international oil supplies. So the day we really ought to get worried is when they figure out how to make their cars go without oil from imported oil.

But to return to the last round of comments about the political impacts and to concentrate particularly on the example of Saudi Arabia which in your briefing that we got, Dr. Mohamedi, from the Saudi perspective, the deal of the 1990s that you referred to, the first priority was to reestablish domestic tranquility, if you will, to reestablish the—and I'll use my own terms—the position of the regime vis-à-vis a public that had gotten out of control from the sense of not being able to be subsidized by oil sales to the same degree, exploding demography, et cetera, et cetera.

So for these—which seems to me a very fine exemplar of what the effects of increased Chinese presence in these economies and in these political situations are, which is to, as Dr. Luft said, to show

up with the money and not ask too many questions about what the regime does with it.

But from an American perspective, from an American national perspective, these are problematic regimes, not in the Saudis, you can cast in both lights, but certainly places like Sudan or Zimbabwe, you know, the ambiguity is far less. So it seems to me that again the political impact not just internationally, not just on the United States, but the political impact of China's involvement in the energy sector and in natural resource issues as well, is to lend support, lend succor, give material materials such as the weaponry it's given to Sudan over the years, that turn out to have hugely negative consequences from an American national perspective.

So this is why the kind of status quo market view of China's activities is disquieting to me. It's not the market impacts per se, but it's the political impacts that flow from again increasing Chinese presence in all these commodity markets.

Mr. MOHAMEDI. There is no doubt that in the world, the commercial world, in the world of not only oil but other commodities, the Chinese have really made a big impact on the world, and they are being noticed in Latin America, in other parts of Asia, in the Middle East and people saying, hey, can I make a commercial deal with them.

To a certain extent, that's where we're at in the Persian Gulf, for example. I don't think we have really seen a projection of Chinese geopolitical might into the region. You're seeing a little bit of that in Central Asia with the Shanghai Group and all of that, but you're not—and to a certain extent you've seen the growing relationship between Iran and China. But let's not forget from a Saudi point of view, and you were saying whether they will turn around to the Chinese and say, hey, look, this is an easier government to work with than the United States, there are several factors going on.

One is that internal to Saudi Arabia, there is a lot of disquiet and demands for change of the system. Secondly, there's the United States sitting now on their borders in Iraq. This is not a trivial matter. So they have to deal with the United States in a very robust way. Plus they want to. This is a very old relationship, and they want to continue to have a—the other thing is that, yes, China has a big market, but also the United States. I mean this is the biggest oil market in the world and why give up the customer, and so it's become a big issue in the last few years.

It's grabbed headlines, but I think we have to put this in perspective, both of our relationship with the region, our presence in the region, and whether Chinese really are not there in terms of power projection or, we have our Fifth Fleet is in Bahrain, which is 17 miles of the coast of Saudi Arabia. This does tell you, put it in perspective.

Commissioner DONNELLY. I see my time has expired, but I think we should pursue this issue in the future.

Cochair WESSEL. Thank you. Commissioner Bartholomew for the last question.

Cochair BARTHOLOMEW. Thank you, Mike. I'm going to take the opportunity to take this focus and tie it into the bigger focus of these two days of hearings.

I have a question and I suppose it's the same way struggling to get to this point. My question would be how much of the presumption—when we talk about Chinese acquisition of energy resources, the presumption I think is that they are acquiring the energy resources for domestic consumption. But if we put it into a bigger context with these other issues that we have been talking about, the vast majority, for example, of Unocal's holdings are in liquefied natural gas.

When you look at Unocal's Indonesia liquefied gas fields provide a significant amount of gas to Japan, to South Korea, and to Taiwan. Look at something as simple as the fact that Unocal's annual report notes that 15 percent of Bangladesh's natural gas requirements are supplied by Unocal and that number is expected to reach 35 percent by 2008.

Now, I know that talking about this in terms of Unocal and CNOOC might be overtaken by events, but the questions are still there. The Chinese government is engaging in cash and natural resource diplomacy throughout the Asian region, and we're seeing the extent going the rest of the world.

What I'm trying to really understand is as we look at your analyses, how much of your presumption is that what they are acquiring these resources for is to fuel their own growth? And do you factor in how much of it—and if that's the case, then what is the future for these other countries that are getting their resources from fields, for example, that the Chinese government is trying to acquire and how much of it is the geopolitics of what they might be trying to accomplish leverage?

If indeed they could cut off or control natural gas flow to Japan, South Korea and Taiwan, that's got pretty significant consequences for what happens in the future politically in the region. Sorry. It's kind of an amorphous question, but you can see we are still struggling with these.

Dr. LUFT. Definitely when you have 1.3 billion people and nearby 1 billion people all of a sudden vying for a lot of energy, it has implications on everybody in the region. I just came back from Taiwan recently and they're, for example, all of a sudden very worried because China's ability to export coal to Taiwan is falling because all of a sudden the Chinese need more for their domestic needs and therefore they cannot export to the traditional markets that they used to, and I believe we will see similar concerns in other countries.

By the way, it works the other way as well. You mentioned Bangladesh. One of the reasons that Bangladeshis are not so optimistic about Unocal's operation in Bangladesh because the Bangladeshis don't want to export natural gas because they say we are one of the fastest growing countries in the world. We're going to need this natural gas for our own future. It doesn't make sense for us to sell it to other countries.

So you have those concerns as well, but I definitely think that the puzzle will reshape itself and we'll be largely affected, or the relation between countries in the region will be largely affected, by their need for energy. That goes for the relation between China and India and between China and Russia. We did not talk much about Russia here, but we need to remember we don't have energy rela-

tions with Russia in this country. We don't. We just don't have relations with them on energy.

It's the second-largest oil producer in the world that we are not even engaging with.

Mr. MOHAMEDI. I think we do have quite a few relations with Russia on industry, and there is a commission set up, and all of that. On the LNG issue, I don't think that CNOOC acquiring Unocal will in a sense deprive those countries of LNG. I do think that—you're right—it's an LNG play because CNOOC, its main acquisitions overseas have been LNG plays. That's what it is starting to concentrate on.

But I think those countries, Japan, et cetera, have quite a diversified slate of LNG purchases from all around the world. The United States is the newcomer to the LNG world, by the way. As we come into that world, we're going to be affecting LNG and gas dynamics all over the world, and everybody is expecting that, and that's an interesting play, and the race is on actually from private oil companies to try to supply the United States as much as possible.

That's my comment.

Cochair WESSEL. Thank you to both panelists. We appreciate it. I hope that we can work with you in the coming weeks, months and years as we look at these issues and appreciate your time. Thank you.

Mr. MOHAMEDI. Thank you.

[Whereupon, a short break was taken.]

PANEL III: FACTORS DRIVING CHINA'S GLOBAL STRATEGY AND U.S. POLICY RESPONSES

Cochair BARTHOLOMEW. Thank you to our next panel. Thank you everybody for appearing. Just brief introductions. We will hear on this panel about factors driving China's global strategy and U.S. policy responses.

We're very fortunate to have with us today someone who can speak directly to the U.S. policy responses since he used to be responsible for them. Randy Schriver is joining us. He's currently working with Armitage International. Prior to that position, Mr. Schriver was a Deputy Assistant Secretary of State for East Asian and Pacific Affairs. He's just returned from the region earlier this so thank you very much for joining us. We thank you for your service to the country and we also look forward to your testimony.

Dr. Steven Tsang is the Director of the Asia Studies Center at St. Antony's College, Oxford. Welcome. Dr. Tsang specializes in China's relations with the outside world, particularly with the U.S., Taiwan and Europe.

His other interests include comparing political developments in China, Hong Kong and Taiwan. He is the distinguished author of nine books, 15 book chapters and over 39 journal articles. I presume he does some writing as he flies back and forth across the ocean.

Dr. Avery Goldstein is with us. He's the Professor of Political Science at the University of Pennsylvania and he also serves as a Senior Fellow at the Foreign Policy Research Institute in Philadelphia where he was the Director of its Asia Program from 1997 to

2002. He is currently conducting research on China's grand strategy in the post-Cold War world, no small topic.

And Dr. Charles McMillion who is the President and Chief Economist of MBG Information Services. Dr. McMillion has previously held Staff Director and Chief Economist positions in the U.S. House and the Senate. He frequently lectures on economics in the U.S., Europe and Asia including four tours sponsored by the U.S. Information Agency. He is also the author of a number of books, four of them, and over 150 scholarly pieces, popular articles and reports. So welcome to all of you and we'll turn it right over. Mr. Schriver, why don't you begin?

**STATEMENT OF RANDALL G. SCHRIVER
ARMITAGE INTERNATIONAL**

Mr. SCHRIVER. Good morning and thank you to the Commission for having me back. I appreciate being here, and thank you for making me look good by including me with such a distinguished group at the table here. It's really my honor.

What I'd like to do in the very brief time is address the topic and talk about Chinese foreign policy and what may be the strategic direction behind their foreign policy and then as you suggest maybe give a few thoughts on U.S. policy responses.

Chinese foreign policy has changed dramatically over the course of the last decade. We see a much more proactive, a much more creative diplomacy, and we see that China has greater capabilities and a widening tool box to bring to their foreign policy and impact their relations outside their borders.

This much is clear, the capabilities side of the equation, and their willingness to employ their capabilities. The other question about intent, I think, and strategic direction is probably a little less clear. China doesn't produce a national security strategy. There is no public document. They do produce a defense white paper, which I will quote from and do quote from in my written statement, but also China remains a very opaque country. Their leadership is opaque and is often in the business of obscuring their actual intent behind their moves.

And the other reason why this may be a bit difficult some of these decisions and issues maybe China is still grappling them their selves. The DoD report that was released yesterday suggests that China is at a strategic crossroads right now and has choices to make about the path that it will take, the kind of relationship that it will have in the United States, the manner in which it will interact with the outside world.

So it's difficult for those reasons. There's not a great deal of clarity from the leadership on these matters, but also it might be still a matter of internal debate. So my own view is that we're left with sort of our best guess, but it can be an informed best guess. There are policy statements and speeches by Chinese leaders. There are growing body of scholarly work by very well informed and connected Chinese scholars, but most important we have a growing data set, if you will, of discrete Chinese decisions and actions and a growing body of evidence in terms of their foreign policy and what might be the strategic intent behind it.

My own view is that rather than having a clear vision of how they want the world to be and what they would do if they accumulate great power and influence, I think their current objective is mostly in the process of accumulating power and influence.

I use a golf analogy. I think China is mostly concentrating on improving its lie, if you will. And so they may not themselves know or maybe just it's more accurate to say it's a matter of internal debate, what they would do once their lie is improved and their vision, but I think their objective in the near term is improving their position in the world.

Now this is not an insignificant observation in terms of what we can still glean from this fact and start to understand Chinese foreign policy and start to understand the decisions that may still be forthcoming because it says several important things.

Number one, they are still very much focused on building what they refer to as comprehensive national power. So a lot of focus on building their economy, building their national defense, their defense capabilities, and so this does involve interaction with the outside world. Comprehensive national power is no longer about ideological purity and rooting out capitalist routers.

This does involve very much interaction with the outside world and, in fact, I think they're inextricably linked to the outside world if they are to achieve their goal of growing their power.

And number two, improving their lie also involves a different kind of power relationship vis-à-vis current existing powers, primarily in the United States, and a concept of sort of world order, if you will. They talk about moving towards a multi-polar world and anti-hegemonist policies.

And so I think even if we want to say there's not great strategic clarity and as I said, in my view, if it's mostly about accumulating power and influence and improving their position, we can still say some important things.

Their economy is key to this goal of building comprehensive national power. That links them into the outside world in very important ways and tells us a great deal about what will drive their foreign policy.

Energy has been discussed a great deal already this morning, but clearly their growing energy requirements will lead them to be very active in their foreign policy and energy producing regions. They're very reliant on the outside world for foreign direct investment and foreign technology and foreign know-how.

They're also very reliant on the outside world for export markets. They don't have the capacity yet in terms of domestic consumption to account for what they're producing. They need the markets abroad. So they're very linked to the outside world in this way. They are also, as I said, thinking about their position vis-à-vis other powers, and I think when they think about the United States, they are subtly engaged in a process of trying to increase their power and influence probably at the expense of ours, and to diminish our influence, not maybe necessarily as a direct head-on challenge, but I think some of what animates their decisions to create the East Asia Summit, for example, or empower other multilateral organizations that we're not in is somewhat oriented towards

this goal of moving toward a multi-polar world and involves I think almost certainly some diminishment of our influence and power.

So this is sort of my thesis. I see my time is running short. Let me very briefly talk about what I think the U.S. policy responses should be as a private citizen, no longer a State Department official. I think there's basically three elements, and I'd be happy to go into greater detail after the opening statements.

First of all, I think our orientation to China should be grounded in a very clear Asia strategy and very solid relations in the Asia Pacific Region. I think we have more work to do on our alliances. I think we have more work to do in Southeast Asia. Everybody talks about the Chinese charm offensive there. I don't think we could necessarily hold it against them that they're trying to improve their relations there, but we need to have a good strategy of our own.

We also need to think creatively about multilateral organizations. China is taking the initiative and creating some of their own. We need to be a player in this regard as well.

Number two, I do think we need to continue our broad and comprehensive engagement of China. I don't think we're necessarily on a collision course where we're going to be adversaries. I think we'll naturally be competitors. And we do still have an opportunity to shape that relationship in a more positive direction.

And then finally, I think there are certain issues that we can't identify at this juncture as issues that will lead us to confrontation if not addressed in a direct head-on fashion. And I think the energy issue is certainly one of those. When we were in government, we tried to recast this issue with the Chinese, and I think we're at an early juncture in terms of doing that, and suggest, yes, this is a commodity that is important to you and important to us, but there are ways to look at this that should drive us closer together and not tear us apart.

China should have a greater interest in nonproliferation and export control. They should have a greater interest in stability and peace in oil producing regions. They should have a greater interest in maritime security. So there are some in the U.S. Government who are trying to think a little more creatively about how we get off a collision course on these particular issues related to energy.

Again, I'd be happy to go into greater detail during the question period. Thank you.

[The statement follows:]

**Prepared Statement of Randall G. Schriver
Armitage International**

China's Global Strategy and U.S. Policy Responses

Introduction

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

Understanding the character and nature of Chinese foreign policy is a necessary element for crafting a U.S. policy response—but it is insufficient in and of itself for the task of crafting the most sophisticated and effective U.S. policy. In addition to seeing China’s capabilities and acknowledging its willingness to actively employ its capabilities, it would also be helpful to understand China’s strategic intent that drives foreign policy decisions. Clarity regarding *both* capability and intent is most desirable from a U.S. Government perspective.

As an outside power, achieving a clear understanding of Chinese strategic intent is highly problematic—a point on which my statement will further elaborate below. The challenge is twofold. First, the Chinese government remains opaque and suspicious of outsiders, and thus is reluctant to be transparent on these matters. And second, China may be in the midst of making strategic decisions at this current juncture, and doesn’t have a clear, cogent strategy from which to make foreign policy decisions.

A Chinese Global Strategy?

China does not publish a national security strategy report (the closest document is the National Defense White Paper from which I will quote extensively—though much of the focus of that document is on arcane military administration), and it does not have a national security council to articulate such a strategy. Further, as stated above, China is an opaque country to those attempting to look in from the outside. China is often in the business of obscuring the actual intent behind its actions.

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

Without an official statement of strategic intent, and with some reason to suggest strategy is still a matter of internal debate in China, we are left to make our best educated guesses about China’s strategic direction. Our best guess, however, can be informed guess. Chinese leaders give public speeches on a range of foreign policy issues. There is an increasing body of scholarly work produced by talented Chinese scholars who articulate well-formed views on strategies that would best promote Chinese interests. And probably most important of all, we have a growing “data set” of Chinese decisions and actions when taken as a whole shed light on China’s strategic direction.

My own conclusion is that China is operating with a primary goal—to use a golf analogy—of “improving its lie.” In other words, if there does indeed exist a strategic objective for the Chinese, it is focused on further developing its comprehensive national power, and further promoting its position in the world to be a more influential and more powerful country. The very essential questions related to Chinese intentions once it has acquired power and influence may be unanswerable, or even may be unknown to China’s leadership.

This observation may not be satisfying to those desirous of clarity regarding China’s future, and the associated questions surrounding the future of U.S.-China relations. However, it is a nonetheless significant observation when one gives consideration to how this might explain current Chinese decisionmaking, and what it may tell us about the major elements of China’s overall approach to the outside world.

Building China’s Comprehensive National Power

China’s own 2004 National Defense White Paper identifies as a basic goal in maintaining national security: “To safeguard the interests of national development, promote economic and social development in an all-round, coordinated and sustainable way and steadily increase the overall national strength.” In other words, to be secure in the international environment entails increasing strength at home.

The language and the concept may at first glance deceive. It suggests a focus inward for Chinese leaders. However, developing China’s strength is no longer about ideological purity and rooting out Capitalist Roaders—the objective of increasing China’s national strength inextricably links China to the outside world, and compels a more assertive foreign policy. This is true in large measure because Chinese power can only increase if its economy remains strong. And further, the health and well-being of the Chinese economy is absolutely tied to the way it interacts in the world beyond its national borders.

Four aspects of Chinese interaction with the outside world deemed critical to the success or failure of the Chinese economy, also serve to inform us about Chinese diplomacy and foreign policy. First, China is highly dependent on the outside world for energy resources—and its demands continued to surge. Again according to the U.S. DoD report, “China currently imports 40% of its oil. By 2025 this figure may rise to 80%.” China perceives an increasing “energy vulnerability” and seeks to minimize risk to its economy by establishing secure access to energy. This has motivated China to aggressively pursue energy agreements with a variety of countries, including countries with which the United States has very poor relations. Chinese interests in places like Sudan, Iran, and Venezuela potentially motivate China to take actions that produce outcomes contrary to U.S. interests. This national-level goal likely motivates the Chinese government to support the efforts of “semi-private” Chinese companies in their respective commercial dealings. China also has a growing interest in secure “logistical means” for the delivery of energy from the outside world into China. The implications for China’s approach to its neighbors in Central Asia, and toward countries bordering key sea lines of communication are apparent.

Second, China is highly dependent on the outside world for foreign investment in the broadest sense—this would include foreign direct investment, of course, but also includes a continuing dependency on foreign “know-how” in terms of management and business strategies, and access to foreign technology. In 2002, China surpassed the United States as the number one destination for foreign direct investment. While the investment is still largely oriented to the manufacturing sector, over time investment is achieving greater diversification. Leading outside sources of foreign investment into China are the United States, Taiwan, Japan, and the EU. These are the same countries largely involved in running many businesses in China, and provide access to new technologies.

Third, China is highly dependent on the outside world for its markets for exports. The Chinese domestic consumption has yet to achieve a state where it can support the robust production coming from China’s manufacturing base. China enjoyed a global trade surplus at a value around \$39.6 billion in the first half of 2005. Its greatest surplus is with the United States—something well known and well-documented by the Commission. While the U.S. has legitimate concerns about such a large trade deficit with China and the implications for our own manufacturing base, it is also true that China has developed a dependency on American and other foreign consumers. This dependency not only has implications for China’s relations with countries representing current export destinations, but also China’s efforts to develop and promote new commercial relationships.

And fourth, China’s wealth is increasingly held in foreign currency and foreign assets—primarily U.S. dollars. Again, this may give China some leverage over the United States in ways that should cause discomfort—but it is also true that the value of their holdings and their wealth is increasingly dependent on a strong U.S. economy.

Another aspect of developing China’s national power is increasing the strength and capabilities of its military. Again, such an objective ensures robust interaction between China and the world outside its borders. China’s 2004 Defense White Paper identifies the goal to “modernize China’s national defense in line with both the national conditions of China and the trend of military development in the world.” China remains dependent on Russia for military hardware and servicing of military systems, and is dependent on the Western world for dual-use high technology. Such dependency in part explains China’s evolving relationship with Russia, and why it pursued the EU arms embargo with such vigor.

Finally, China’s ability to grow its power domestically entails sustaining control of where it invests national resources. For China to modernize its economy and grow its wealth, China cannot afford major diversions of resources to causes unrelated to the objective of strengthening national capabilities. In short, China needs stability in its neighborhood and in its relations with other great powers so that resources are not diverted from roads, bridges, hospitals, schools, etc. China has pursued robust diplomacy on its periphery to secure a stunning number of border agreements over the last decade, including on historically contentious borders with Russia, India, and Vietnam. China’s interest in stability may also explain a mostly consistent approach toward the United States in the form of positive engagement.

Promotion of Multi-polar Order and the New Security Concept

Improving China’s “lie” is not limited to nurturing its economic development at home and growing its comprehensive national power. It also entails improving China’s relative standing in terms of power and influence vis-à-vis other countries—in this regard, China primarily has the United States in mind.

Chinese speeches and writings are steeped with language against hegemony, and for the promotion of a multi-polar world. Recently in Gleneagles, President Hu Jintao noted “world multi-polarization and economic globalization moving ahead” and emphasized the need to “work for a common future through win-win cooperation.” Li Zhaoxing has been more direct as he was in a 2004 interview saying “hegemonism has been a threat to development. Nobody in the world likes hegemonism, and everyone opposes hegemonism and advocates multi-lateralism.” Some Chinese leaders go even further when they offer assurances related to a future environment where China has a greater say in things—Wen Jiabao said earlier this year “Even if we grow strong in the future, we will hinder nobody, not to mention threatening anyone. China will never seek hegemony!”

In the defense community within China, further structure has been granted this vision of multi-polarity, anti-hegemony in the form of what defense officials describe as the “new security concept.” Again to quote China’s 2004 Defense White Paper, it is a stated goal “to pursue an independent foreign policy of peace and adhere to the new security concept featuring mutual trust, mutual benefit, equality and coordination with a view to securing a long-term and favorable international and surrounding environment.” In formal presentations, senior leaders of the PLA have stated that bilateral alliances and military basing outside one’s sovereign territory is inconsistent with the new security concept.

In the current environment, the notion that world multi-polarization is moving ahead is likely more theoretical than reality. However, it should not be dismissed as only China’s “wishful thinking.” It is a vision that animates some Chinese foreign policy decisions, even if in subtle ways. It also represents the most direct challenge to U.S. policies and the U.S. position in the world. When China speaks of hegemonists it is a thinly veiled reference to the United States. When it speaks of multi-polarity, almost by definition it is statement of intent to see a relative diminishment of U.S. power and influence.

There are real foreign policy consequences and potential impact on U.S. interests stemming from a stated “anti-hegemonist, pro-multi-polar” vision. China has worked steadily to improve relations with countries in Europe which is commendable. However, some Chinese scholars see this as a move to strengthen relations as a hedge against U.S. influence. China’s newfound strategic relationship with Russia also appears to be subtly oriented against the United States. And China seems quick to court any nation that seems disaffected by the United States (e.g. the Philippines after President Arroyo’s decision to withdraw from Iraq).

China has also invested energy and resources into empowering multi-lateral organizations in which the United States is not a member, and at the same time, orienting the agendas of such organizations to hedge against U.S. influence. Last month, China initiated a proposal within the Shanghai Cooperation Organization (SCO) that Central Asian countries should set a date certain for the withdrawal of U.S. troops from those same countries. This was a clear attempt to address a very important issue to the United States (the troops are deployed to help prosecute the war on terror) in a forum in which the United States does not even participate. China is also actively promoting the development of an East Asia Summit (EAS). This remains an event with no known agenda, and no final participant list. The only clarity seems to be that the EAS is a Chinese initiative, and the United States is not invited.

Just Being There

In addition to growing national power, and encouraging anti-hegemonism and multi-polarity, China has a growing appreciation that being a global power entails engagement, participation and representation on every continent on the globe, and in every meaningful multi-lateral organization. Part of “improving its lie” means you don’t allow meaningful conversations to take place without you being in the room. China has joined organizations such as the Organization for American States as an observer, seeks a seat on the Inter-American development bank, has increased international development aid to Africa and the Pacific Islands, and has become an active participant in international peacekeeping (including sending 125 peacekeepers to Haiti). While one could parse each decision individually and find an anti-Taiwan motive, or energy security motive, perhaps the true motivation for such engagement might simply be a desire to be at the decision table “just in case.” Even if China lacks a coherent global strategy, it can still be true that it harbors global ambitions. In this regard, China may feel as though remote corners of the globe cannot be completely ignored if other outside countries are involved and engaged. “Just being there” may also contribute in some intangible ways to China’s status and image as a global power, thus translating into increased influence.

Taiwan

Taiwan is a sui generis issue for China and deserves special and distinct mention. One should not underestimate the neuralgia among Chinese leaders on questions related to Taiwan, and the implications for Chinese foreign policy. Whereas there may be a lack of clarity regarding China's overall strategic direction, there is complete clarity on the question of Taiwan. China does not tolerate suggestions that Taiwan is anything but China's sovereign territory. This animates Chinese foreign policy in consequential ways and its behavior in the world. China uses foreign aid as an incentive to lure countries away from sustaining diplomatic relations with Taiwan. It pressures countries with which it has relations to avoid any positive interaction or engagement with Taiwan at all. And it uses its influence in multi-lateral and multi-national organizations to isolate Taiwan as much as possible. China has arguably enjoyed some success in its campaign to isolate and coerce Taiwan—but it may ultimately be an Achilles heel to China if it allows its emotions over Taiwan to drive decisions that are otherwise irrational in terms of China's own interests.

U.S. Policy Response

President Bush referred to the U.S.-China relationship as “very good, and very complex.” This is an odd way to describe a relationship. However, it strikes me as a concise, even eloquent way of speaking about the unique challenge we face from China's ascent, and its more assertive participation in global affairs. Though we have quality and constructive interactions with China, our profound differences over such core value issues as human rights and religious freedoms prevent truly close partnership.

I believe our orientation to the challenges associated with China should consist of three elements. First, our approach to China should be rooted in a clear vision for Asia, and a strong Asia strategy that accounts for China's ascent. Though I would not hazard to offer a complete Asia Strategy in this statement, I will suggest below some of the key elements of an approach to Asia that may give us an enhanced ability to meet the challenges associated with China. Second, the U.S. should continue to promote comprehensive and sophisticated engagement of China. And third, we should begin to address challenges of a global nature—particularly the energy challenge—in a direct, head-on manner during what is still an early juncture in China's transformation to country with a global power mentality.

Regarding Asia, the United States should seek to sustain and strengthen bilateral alliances with Japan, Australia, and South Korea—with a particular focus on the U.S.-Japan alliance. While it is true that virtually every paper on U.S. policy toward Asia begins with this point, it is not a mere platitude. As China increases in importance, it might lead some to make sacrifices in our relationship with Japan in the hopes of accommodating China. That would be a mistake. The United States should welcome Japan's emergence as a more pro-active player in Asia, and we should grow more comfortable as an alliance in planning for future uncertainties in the security environment—China's posture in Asia very much included. On questions of “Asian history” we can stand back—but we should in no way posture ourselves as neutral if China provokes tension in its relationship with our treaty ally Japan.

The United States should strengthen relationships in Southeast Asia, and demonstrate a genuine interest in the problems and challenges of friendly countries there. Many in Southeast Asia look at the United States as “Johnny One Notes” on Counter-terrorism issues. Though this is unfair (particularly in light of our generous response to the Tsunami tragedy), there is a perception of the United States that we haven't countered effectively enough. While we cannot prevent China from pursuing quality relations in Southeast Asia for herself (nor would we necessarily want to), we can demonstrate that we are still a better interlocutor, partner, and reliable friend in times of need. In short, we will not “beat China” by countering Chinese policies, but we can gain advantage by offering an even better Southeast policy of our own. Strengthening ties with Singapore, Indonesia, Vietnam and ASEAN as an institution are key for U.S. interests. The United States might consider ways to resume cooperation with New Zealand under the ANZUS treaty for certain “carve outs” (e.g. PSI exercises or CT exercises). Despite our differences over the nuclear issue, a partial revival of ANZUS would be a powerful message to Southeast Asia of our enduring interest in the region.

It is essential that the United States adopt a force posture that is appropriate for 21st century challenges in Asia—the uncertainties related to China's strategic direction very much included. While its true current efforts to review force posture are long overdue in Asia, it is also true that the timing of our efforts have caused widespread concern. Many in Asia believe a force posture review is cover to re-orient our forces to the Middle East and elsewhere outside of Asia. The United States can send

early signals to counter these perceptions. For example, the United States could commit to sustain a presence that is even greater than what our force posture today offers. This does not have to be accomplished through traditional permanent basing. Rather, the U.S. can commit to more robust long-term training, and more diverse training locations (as far and wide as Australia—where we are to develop a new joint training facility—to Mongolia—where the U.S. has the chance to increase funding for Mongolia’s international peacekeeping training center at Five Hills).

The United States should seek to strengthen existing multi-lateral organizations like APEC and ARF. Asians have historically preferred their multi-lateral organizations weak. The United States, however, should not miss an opportunity to promote our interests through the vehicle of multi-lateral organizations, particularly as China endeavors to empower organizations in which the U.S. is not a member. Introducing a security agenda into APEC three years ago was a good first step (and it should not go unnoticed that China is the single biggest obstacle to forward movement on that agenda today). However, the United States’ financial contributions to APEC are paltry (for example, they are a mere fraction of our contributions to OECD despite that fact that APEC economies account for a much larger percent of our trade). The U.S. can still be an agenda setter in these organizations, and we should not fail to do so.

And the United States should also explore the creation of new multi-lateral security mechanisms. China is aggressively pushing for an East Asia Summit (EAS). There is still no agenda or clear participant list for such a meeting—we only know the United States is not invited. One possibility might be an initiative to hold a meeting between the United States and all its treaty allies in Asia, plus Singapore. Others have suggested sponsoring a meeting of like-minded democracies in Asia. While China may rhetorically complain such gatherings are designed to plan against them, we would almost certainly have a broad agenda to discuss with our friends that would touch only tangentially on China (issues like counter-terrorism, maritime security, counter-narco-trafficking, etc.).

Sustaining U.S. bilateral engagement with China is also key to securing positive outcomes for the United States. Some might read the paragraphs above as descriptive of a plan to “contain” or “constrain” China. Not only would containment efforts fail, they would likely lead to a diminishment of U.S. influence in Asia, rather than an improvement in our standing. I believe that the core elements to the policy chosen by every Administration over the course of the last 35 years are sound. To critics, a policy of broad engagement of China is more descriptive of a “process” rather than an actual “policy.” But it remains true that broad, comprehensive engagement of China allows the United States to pursue our interests in areas where the U.S. and China agree, while minimizing the chance of conflict resulting from areas where we disagree. There is also sufficient evidence that our broad engagement of China has contributed on the margins to internal change in China for the better.

It is essential that the leadership in the United States speaks with clarity about our vision for China, and that our actions match our words. Welcoming a China that is more influential and powerful, and welcoming China’s active participation in regional and global matters in word and deed is critical for making the right kind of impact on Chinese leaders. This should not take away from our message that we will seek to shape the environment, as well as be prepared to deal with China if it chooses an adversarial route.

There are likely new opportunities to add to our traditional modalities for engagement of China. For example, the U.S. and China can intensify attention to so-called “global issues.” As Wen Jiabao conveyed while visiting the United States in December 2003, any problem magnified by 1.4 billion people is a very large problem. Environmental degradation and inattention to infectious disease are not problems that can be confined to within China’s borders. Investment and attention to these areas make a direct contribution to the globe’s well-being.

I also believe we should intensify, not weaken efforts to promote human rights and religious freedom in China. As China’s influence grows, the tendency of most countries will be to curtail criticism of China’s internal practices. China is clever in its diplomacy in that it often conveys to interlocutors that “non-interference” in Chinese affairs is the price of admission for a quality relationship with China. However, the best hope for a constructive China in regional and global matters still rests in the hopes of a reformed China.

As an issue related to our direct engagement of China, I also endorse sustained U.S. support for Taiwan. As stated before, Taiwan is *sui generis* for Chinese leaders—it may even be viewed as a regime survival issue. I believe sustaining Taiwan’s current status is of increasing importance to the United States as China emerges as a country with regional and global ambitions. Taiwan is a democracy, a free market economy, respectful of human rights and religious freedoms, a like-minded

friend on matters related to counter-terrorism and combating proliferation, and a major investor in China. Taiwan is poised to be part of what changes China for the better if Taiwan is preserved as a free democracy. It also has the potential for high quality regional citizenship (e.g. major contributor to Tsunami relief; leader in research and investment for combating infectious disease) if it orients its foreign policy accordingly.

The third element I mentioned is the need to address areas of potential tension head-on as China emerges as a stronger global player. Chief among such issues in my view would be the energy security challenges. Though there may be numerous potential sources for tension, questions related to the growing competition over energy resources are in many ways the least understood, and the most dangerous. China's foreign policy is increasingly driven by what it perceives as its requirement to establish secure access to energy. A survey of various Chinese diplomatic initiatives would suggest that China may perceive the issue as a zero-sum equation. Adopting such a framework is opting for train wreck. If addressed directly, there may be an opportunity to re-cast energy requirements in the minds of Chinese leaders. Growing needs for energy creates not just competition—but also a range of shared interests. We should vigorously pursue Chinese involvement in Maritime Security, non-proliferation practices, and operations to promote stability in the Middle East all under the banner of energy security.

Conclusion

A profound transformation has occurred in Chinese foreign policy. In Foreign Affairs in 2003 Taylor Fravel and Evan Medeiros noted that Chinese scholars write less about a Chinese foreign policy motivated by “150 years of shame and humiliation” and more frequently about the need to adopt a “great power mentality.” This transformation in self-perception is informing a more robust and creative diplomacy for China.

What is observable verifies that China is growing in terms of its comprehensive national power and is more willing and able to promote its interests through the exploitation of its power. What cannot be observed nor quantified with specificity is a Chinese global strategy. This may be the result of intentional Chinese obfuscation, or a reflection of the fact that China lacks a clear strategy. Nonetheless, we can observe that China is enthused with the notion of acquiring more power and influence—even if it does not have a fully formed view as toward what end its influence may ultimately be used.

Given this framework, we can still make assumptions about current and future Chinese decisionmaking, as well as a starting point for the formulation of the best U.S. policy options. Some of the elements I've noted with respect to China's interests contain apparent contradictions—for example, the need for U.S. foreign direct investment, access to the U.S. market, and the need for stability in relations with the United States all lead one to conclude China will continue to require good relations with Washington. Yet at the same time, China's vision for an “anti-hegemonist, multi-polar world,” and its insecurity over Taiwan suggest there are difficulties ahead.

China will continue to face discrete decision points in the global arena that will impact U.S. interests, and those of our friends and allies. It is important that China sees incentive in making choices that lead it down a path of peaceful integration and benign competition. The United States and others have an opportunity through engagement with China, through shaping the environment of the region in which China resides, and through framing issues such as energy security as win-win to persuade Chinese leaders to make the right decisions.

Chairman D'AMATO. Thank you, Mr. Schriver. Dr. Tsang.

STATEMENT OF STEVEN TSANG DIRECTOR, ASIA STUDIES CENTER, ST. ANTHONY'S COLLEGE, OXFORD

Dr. TSANG. Thank you very much for inviting me here. I think what I propose to do in about seven minutes time is to give a rather broad-brushed assessment from my own particular perspective of China's approach to the relationship with the rest of the world, and I will basically focus on five different issues. The first thing I want to talk about is what perspective should one look at China and indeed what perspective does China look at the world in terms of its relationship with the world?

Often, one sees China being described as a rising regional power, but I'll put it to you that from the Chinese perspective, this regional power concept is an alien one. From the Chinese historical perspective even the concept of Asia and therefore China being part of the Asian world is again a modern import from Europe.

When China was still a great empire, which was really all the way up to the middle of the 19th century, its worldview was a completely global one. What was being limited was the means of communications technology of the time, but for the world that China had any contact with, China was the only superpower.

This leads to the second point that I want to highlight which is if one looks at Chinese foreign policy and looks at it in terms of a timeframe, a very long-term perspective and a rather shorter term perspective, the two things become very, very different. In a very long-term perspective, the global perspective becomes very important because in this very long-term perspective, the Chinese still are thinking in terms of what is the rightful place for China in the world?

In a very simplified way, I would have thought that for the Chinese, the position the United States enjoyed prior to 9/11 and not expecting that to happen would be a position that the Chinese would feel very comfortable in, that it would be the roughly the place that it enjoyed for about 2,000 years, and why should it not be restored?

But in the short to medium term, the Chinese are realists like everybody else. They totally realize that there is no way that the Chinese could compete with the Americans head on, and that's why they put so much more emphasis on multinationalism now and in terms of the U.N. framework.

This commitment is necessary in order to maintain and advance Chinese interests. But it doesn't mean that the Chinese are so committed to the multinational institutions that once they have built them up, they will always be committed to them.

The third point I want to emphasize is this Chinese concept that had previously been in the Communist world of the united front. For the Chinese, the united front is not a policy; it's a methodology. Very briefly, the united front essentially is an idea that you have to identify your friends from your enemies. At any one point you identify one principal enemy, you focus on that enemy and between you and the enemy is a huge intermediate zone. You work on countries in this zone, you make sure everybody thinks that you're only interested in dealing with the principal enemies so you validate support or at least neutralize the opposition. You destroy your primary enemy, then from your intermediate zone you find a secondary enemy who will become your primary enemy, and you repeat the process and eventually you have only friends and no enemies.

The fourth point I want to talk about and emphasize is, I will even use the word, the "centrality" of Taiwan in terms of Chinese security and strategic thinking in the short to medium-term. This in a sense really all comes back to join onto the earlier points I make in terms of the perspective, in terms of the timeframe, in terms of the competition, in terms of the united front way of thinking.

They see Taiwan rightly or wrongly as a part of China and they will want to have Taiwan back whatever the cost. They would hope to pay a very low price for it. But if they have to pay a price for it, they will be prepared to pay the price for it when the time comes, but they can wait. They'll wait until they think they can actually take Taiwan unless the situation in Taiwan is changed and their hand is, from their particular perspective, being forced, in which case they will act much more quickly.

Until they have resolved Taiwan, which in the united front way of thinking, is the principal contradiction, they are not going to actually antagonize too much of the others; hence, so much emphasis on the peaceful rise of China and also in terms of cultivating relationships with the Asia Pacific companies, Southeast Asia in particular, and they do see in this important relationship with the United States that Taiwan is a key issue.

Trade and economic complementarity are very well and very important and they are serious, but if the chips were ever to come down, Taiwan or trade, Taiwan they will go for any time. So it's a very serious matter. I don't think they are set on a completely collision course because I don't believe in determinism. I think things can be changed and there are ways of changing it.

Here I think I want to make my last point, which is that having said all this about the United States and China being in the very long term competitors, one also has to take into account that that perhaps applies much more to the current regime in China, given its particular background, its particular history and its particular way of dealing with the rest of the world.

Will the current regime continue as it is and indeed can it continue as it is on a sustainable basis over the very long term? That to me is a serious and real question. I personally do not believe that they can maintain the current system and the current regime for much more than say 20 or even 30 years. One way or the other things will change. They either will have a situation where they will have such an economic miracle and success that you will create such a large middle class in China and the Chinese middle class will behave like middle classes anywhere else. Once they have, if you like, watched color television, they don't want to go back to watch black and white.

They will generate the same kind of demands for the regime, and if the regime does not reform, they will face a crunch time. Likewise if, of course, the economic reforms cannot be sustained, then you will have a very serious problem of the legitimacy of the Communist regime that was requiring so much instability and economic growth since 1989 for it to be sustainable.

So I think in the long term that is a question. It's really a matter of what can be done to engage the Chinese and I think in engaging the Chinese in political issues, engage Chinese on whose terms, Chinese terms or American terms? And if what the Chinese fear most is what they used to call the American conspiracy of a peaceful evolution of China, then you should deliver that.

Thank you very much.
[The statement follows:]

**Prepared Statement of Steven Tsang
Director, Asia Studies Center, St. Antony's College, Oxford**

China's Approach to Relations With the World

A rising power that is often deemed a potential superpower with the ability to rival the United States, China is generally seen as the most important emerging regional power. While such a view appears to be justified if one looks at China's military capabilities, growth rate and the focus of its security and economic policies, this is also misleading. Both historically and since the founding of the People's Republic in 1949, China in fact sees its relations with the rest of the world in a global rather than a regional perspective. Its short term focus upon East Asia is dictated by realism and its particular approach to dealing with the outside world, which is intricately tied to its view of history. Whether China can and will become a superpower also remains to be seen.

The Chinese Perspective

Even though the mainstream or Communist Party approved view of history in China deviates significantly from a judicious reconstruction and assessment of Chinese history in key areas, it nevertheless reflects and reinforces the way the Chinese leadership sees China and its place in the world. In its officially endorsed history China was the most advanced country and the centre of civilization at least since it became united under the First Emperor in 221BC—until this was changed by the rise of Western imperialism in the nineteenth century. In this view civilization flourished when China was a united country and dominated in a “benign way” the world within its reach—those who lived beyond the reach of its civilization were generally dismissed as barbarians. There is therefore an unspoken understanding that the restoration of China to the pre-eminent position that it historically enjoyed, before it was successfully challenged by Queen Victoria's British Empire, will be a positive and civilizing development for the world.

To make this view easily comprehensible, imagine how the citizens of Rome would have felt if the Roman Empire, a contemporary of China's first empire, had continued to exist as a united empire (albeit interrupted by periods of disunity) and as the world's premier power and technologically and administratively the most advanced state governing most of Europe for almost 2,000 years. Such a view of history accounts for China's Sino-centric worldview.

Seizing on Western powers and Japan's imperial activities in China following the first Anglo-Chinese War (1839–42), which marked the beginning of China's “century of humiliation,” the Chinese Communist government played up the theme that China was a victim of imperialism. In the officially approved view in China, imperialism is either Western or Japanese or even Soviet in origin but it is never Chinese regardless of the nature of Chinese rule in, say, Tibet. Following this line of thinking China has a right to redress this “century of humiliation” and to restore itself to its “rightful place” in the world. The retrocession of Hong Kong from Britain in 1997 was therefore seen as a landmark in this direction. What is now deemed the most important legacy of Western, in this case American, imperialism is the separation of Taiwan from China.

China also tends to look at the world in a global rather than regional perspective as the concept of Asia was an alien one in pre-modern China. The idea of China being part of Asia is a modern import.

To say that the Chinese worldview is essentially global does not imply China does not behave like a regional power as well, particularly before it can build up sufficient “comprehensive national strength” to enable it to challenge U.S. dominance. Realism and a hard-nosed calculation of interests and capabilities apply as much to the Chinese as it does to most governments. Thus, the Chinese government accepts that in capability terms it is still only a major regional power, and must adhere to the late Deng Xiaoping's dictum to bide its time before seeking to restore its “rightful place” in the world. In this interregnum, and in light of the U.S. pre-eminence in the post-Cold War world, China puts great importance on international organizations in general and on its United Nations Security Council seat in particular. They are useful in countering the preponderance of the U.S. Furthermore, while it is still building up its “comprehensive national strength” it refrains from taking an assertive role in world affairs other than protecting its interests. Although it is not articulated China reserves the right to change its attitude towards multilateralism and international organizations when it is ready to assert its “rightful place” in the world.

Another key concept that underlays the Chinese approach to relations with the rest of the world is that of the United Front. This is not a policy but a methodology inherited from the era of Mao Zedong. In the simplest terms, the United Front re-

quires the Chinese Communist Party to identify a principal enemy, its supporters outside the Party, and the intermediate zone full of “wavering elements” that can be won over by either the Party or its principal enemy. The Party’s task is to destroy the principal enemy, which requires the Chinese government to work hard to win over the intermediate zone and isolate the principal enemy. Once this has been accomplished the Party will move on and identify from the intermediate zone a new principal enemy. This will become the target of focused attack in this new stage until it too is destroyed. The process is to be repeated until all in the intermediate zone have come under Chinese leadership.

China’s Approach to the World

By drawing together the various forces that affect the making of China’s policy towards the outside world and applying them to the current international scene, China’s handling of its external relations can be put in context. There are three dimensions that come out strongly:

In general terms while China is building up its “comprehensive national strength” it needs a stable and peaceful international environment to ensure rapid growth under the leadership of the Communist Party.

In national security terms, China’s main focus is Taiwan, and until this “principal contradiction” has been resolved to its satisfaction, it is China’s policy to reassure the rest of the world that China has no territorial or aggressive ambitions.

In the long term and when China is ready it will assert its “rightful place” in the world, which may require appropriate changes being made to the international system.

The first dimension requires China to present itself and act as a “status quo power” in the foreseeable future notwithstanding its own agenda to change the status quo over Taiwan. This policy is driven by a key domestic imperative and long-term strategic thinking about bidding time to enable China to rise to the top. The domestic imperative is rooted in the existence of a *de facto* “social contract” between the Communist Party leadership and the people of China after the Tiananmen crackdown of 1989. This involves the Party delivering social stability and steadily improving living standards on the basis of rapid and sustained growth in return for the general public’s acquiescence to continued authoritarian Party rule. This underlines the great importance the Communist leadership puts on deepening economic reform and promoting steady growth whilst staying in control. This requires a benign international environment and continued inflow of foreign investments. Since China will need at least a couple of decades before it can reform its economy to make it genuinely competitive globally and build up sufficient capabilities to assert itself in the way it would like, China needs to behave like a status quo power. It was partly with this in mind, and partly in line with the United Front that the idea that China’s rise will be peaceful was introduced. Despite toning down in propaganda over this concept after Hu Jintao took over leadership from Jiang Zemin, this idea will almost certainly be revived and promoted in a modified form.

In line with this thinking, China wants to maintain the status quo in East Asia. Hence, it will not use its leverage over North Korea to the full to resolve the current nuclear impasse between North Korea and the U.S. unless it is forced to do so. To be sure China would have preferred North Korea not to have developed nuclear weapons or to have brought about the current tension. However, once the U.S.-North Korea standoff started in 2002, China found itself caught in the middle. On the one hand it tries to avoid a showdown and on the other hand works to pre-empt an implosion of the North Korean regime. Either will upset the stability, order and basis for rapid economic growth in Northeast Asia and, as such, harm Chinese interests. Provided it is not leading to an uncontrollable escalation a continued standoff appears the least unappealing option to China, as long as it can resist external pressure to use all the leverages it has to rein in North Korea.

Maintaining the status quo in East Asia generally, including Taiwan in the short to medium term, is the objective of China even though its main focus on security is Taiwan itself and it wants to gain control of Taiwan. There is no question that China is ultimately prepared to use force against Taiwan if the latter should assert *de jure* independence or all other options to pre-empt such an eventuality should fail. However, this is the last resort for China. In its long-term strategic view, the best outcome is to weaken Taiwan’s international standing and capacity as well as political will to resist so much that Taiwan would eventually agree to negotiate for unification under overwhelming Chinese military pressure but without requiring Chinese forces actually staging a full scale invasion of Taiwan. This will enable China to acquire Taiwan and all the capabilities and resources Taiwan has for its own benefit. A less desirable outcome would be for China to use decisive force to subdue Taiwan quickly and before the U.S. could respond and interfere. However,

given the current military balance across the Taiwan Strait and the disposition of the U.S. to help Taiwan defend itself against an unprovoked attack, the Chinese prefer to keep the status quo, which includes pre-empting Taiwan from asserting *de jure* independence.

China's approach towards Taiwan reflects the application of the United Front principle in a spectacular way. While Taiwan is being identified as its principal contradiction, its real obstacle to secure Taiwan is the U.S. The rest of the international community is in general terms seen as "the intermediate zone" though Japan is deemed sufficiently close to the U.S. over Taiwan that it is, like the U.S., subjected to creative tension and wooing. Given the effect of the Communist Party's own propaganda over Japan's imperial past, its expectation that Japan is its key rival in the region, the fact that Taiwan was a Japanese Colony between 1895 and 1945, and the long-standing U.S.-Japan defense pact, the Chinese government believes it can at best neutralize Japan rather than win it over in a showdown over Taiwan. Thus, while the immediate cause for the recent tension between the two countries was the release of new Japanese textbooks and Prime Minister Junichiro Koizumi's insistence to visit the Yasukuni Shrine, the Chinese government took a very robust position towards Japan while it also offered to ease tension. As to the U.S., since it is not at this stage militarily prepared to take on the U.S. over Taiwan China sees much value in taking advantage of their temporary coincidence of interest—to make sure the Chen Shui-bian administration in Taiwan does not probe Beijing's redline too hard. China's courting of the European Union (EU), in contrast, reveals the other side of the United Front at work. From the Chinese perspective the EU can be induced not to support the U.S. over Taiwan. Hence, the assiduous Chinese efforts to enhance links with the EU, encourage EU leaders to think of the EU as a key player in a multi-polar world, and lobby the EU to lift its arms embargo against China. Even if the last should fail it will have the effect of creating serious tension between the U.S. and the EU. In a similar way, the rest of East Asia has been reassured of China's good neighborly intentions by China playing up the value of multilateralism in the region, and stressing the uniqueness of "the Taiwan question."

Within Taiwan itself, the Chinese United Front also requires its government to attempt divide and rule. Thus China focuses its hostility upon President Chen Shui-bian, and refrains from ruling out talking to others in Chen's party while it works untiringly to court the opposition parties in Taiwan. This is meant to complement its longer term strategy to promote economic integration between Taiwan and China, so much so that it would become economically suicidal for Taiwan to allow hostilities to erupt between it and China. The increasing number of Taiwanese working and living in China further gives China a critical instrument—hostages with over a million votes through family members back in democratic Taiwan—to undermine Taiwan's will to resist when China is finally ready to force Taiwan to accept unification under overwhelming military pressure.

The real long-term test of China as a member of the international community will come only after it has resolved the Taiwan issue to its satisfaction. Unless the situation within Taiwan itself should change dramatically, to the extent that it would either present an opportunity for China to seize it at little cost or force China to use force whatever the costs, China will not seek a resolution until it has built up sufficient "comprehensive national strength" to take on the U.S. successfully. Such a development may take decades if indeed it can be reached at all.

If the nature and disposition of the Communist Party leadership and the political system remain essentially unchanged when China reaches a state of development that it can afford to assert its "rightful place" in the world, such a turn of events will almost certainly not be as peaceful as Chinese propaganda today portrays. It will involve a contest of strength and diplomacy between the established superpower and the new emerging one. This point will not be reached in the coming decade as China cannot develop fast enough to turn itself into a superpower in such a time-frame.

Superpower in the Making?

In making a long-term assessment of how China will approach its relations with the rest of the world it is essential to take into account two intricately linked caveats. The first is whether China's rapid growth of the past quarter of a century can be sustained on the longer term basis. The second is whether China's authoritarian system based on the monopoly of power by the systemically corrupt Communist Party can last without transforming itself.

In an important sense there is no authoritative answer to the first question. One can turn to history for guidance, particularly by looking at the experience of other East Asian "miracle economies" post-war. On such a basis there is a serious ques-

tion whether China can sustain such a high rate of growth uninterrupted for another two to three decades. Indeed, with so much of China's growth being driven by foreign investments, it faces a grave danger that its growth momentum may collapse if, for example, a critical mass of the largest foreign investors no longer accepts that it is worthwhile to take substantial losses for many years before turning a profit. Whether the Chinese economy can avert collapse should major foreign investments scramble to leave China for other more profitable destinations is a serious question that needs to be bore in mind.

Should the Chinese economy be hit by a recession or a significant and sustained downturn, the capacity of the state to deal with the many problems that were created or accentuated in the last quarter century of economic reforms will be weakened drastically. The problems include environmental degradation in the air and on land and water, widening gaps between the rich and poor as well as between the rural and urban areas, bankruptcy of the banking sector protected only by the lack of transparency, unemployment, the end of the social safety net, and social problems created by a huge gender imbalance. In such an eventuality the legitimacy of the Communist Party rule will be challenged and the *de facto* "social contract" can collapse. The capacity of the regime to reassert its authority and sustain itself will be sapped further should there be an intense struggle for power at the top causing political paralysis. In other words the Communist regime and the Chinese economic juggernaut are in reality brittle in nature. When all is well they look hard and strong but they can disintegrate quickly with little warning should their key weak points be hit hard.

If the Chinese economy should turn out to be a real miracle and continue to sustain an average growth rate of seven to eight percent per annum compounded it will result in a dramatic expansion of the middle classes in the coming two to three decades. Despite tight government control over the media, communication and the Internet, the new expanding middle classes will witness and be part of the ever quickening changes worldwide. Like people of different nationalities, including the Chinese of Taiwan, once they have a taste of the middle class lifestyle, most will find the Communist authoritarian system stifling, repressive and intolerable. Will they continue to accept the *de facto* "social contract" with the Party? When sufficient momentum has been gathered for political reform, the Communist regime will either have to face down such a challenge by repression or reform itself drastically.

The important point to note is that steady and sustained growth of the Chinese economy, and the continuation of the existing political regime should not be taken for granted in the long term. This applies without having to underestimate the capacity and the political will of the Communist Party regime to deal with any challenge harshly. Whether repression can succeed in the long term is an open question. The implications for China's relations with the rest of the world are that China's rise and the trajectory of its rise may turn out to be very different from what China preaches, and domestic developments in China will have a huge impact on its external relations.

While it will be ill-advised for any major power to designate China as an enemy since this may turn into a self-fulfilling prophesy, it will be equally ill-advised to take the Chinese narrative of its rise at face value. The key to making sure that China will not in the long term turn out to be a major revisionist and therefore destabilizing force in the world is to ensure China reforms itself politically. If the Communist Party regime can transform itself into something that is recognizably democratic, liberal and respectful of the rule of law, it will have greater capacity to deal with corruption and power abuses through checks and balances, and face up to its huge socio-economic problems by persuading its citizens that its government is doing what it can with their voices being heard. It should also enable the Chinese government to jettison its historic "chip on the shoulder," gradually abandon its worldview inherited from the era of Mao Zedong, and eventually accept that its "rightful place" in the world is that of a responsible member of the international community as it is rather than as the Communist Party would like it to be.

Cochair BARTHOLOMEW. Thank you. Dr. Goldstein.

**STATEMENT OF AVERY GOLDSTEIN
PROFESSOR OF POLITICAL SCIENCE, UNIVERSITY OF PENNSYLVANIA**

Dr. GOLDSTEIN. I want to thank the Commission for inviting me to share my views with it today. As indicated in the letter of invitation I received, I'm going to present my understanding of China's

international objectives and the factors shaping China's global relations.

I would suggest that China's global relations today reflect a grand strategy whose central purpose is to enable the country to emerge as a true great power sometime during the 21st century. The elements of this strategy came together in the mid-1990s as the leaders in Beijing more clearly recognized the stiff international challenges they faced in pursuing this goal.

I'll begin by briefly explaining the origins of the strategy, next describe very briefly some of its basic features and finally discuss its implications for U.S.-China relations and U.S. policy towards China.

I think four factors explain why China embraced its current foreign policy approach in the mid-1990s. First, U.S. strength. By the mid-1990s, Chinese analysts recognized that unipolarity was going to last for at least several decades and that for the foreseeable future, China would have to operate in a setting where the United States would have the ability to frustrate China's international ambitions.

Second, China's weakness. Although China's economic and military capabilities were growing, it still lagged far behind the world's leading states, especially the United States. Perhaps most significantly, as China's leaders witnessed U.S. military operations during the 1990s, they more clearly recognized just how far they had to go before their armed forces were in the same league as the United States and its allies.

Third, nervous international reactions. Even though China remained economically and militarily outclassed in the first half of the 1990s, its growing capabilities had already begun to prompt others to debate China's rise and led some to react in ways that could damage China's interests. Against this background, I think China's leaders were alarmed by Washington's efforts in the mid-1990s to upgrade or update our alliances with Australia and Japan and were also alarmed by American efforts to enhance U.S. military cooperation with the nations of Southeast Asia.

These were trends that Beijing worried might be the beginnings of an American-led regional effort to contain China.

Fourth factor here were the tensions in the Taiwan Strait in 1995-96. The mini-crisis over Taiwan at that time and especially the American reaction to China's military exercises, for Beijing this meant that in addition to any long-term hypothetical concerns they might have about the United States and its allies trying to frustrate China's rise to great power status in the long run, that China had to worry about a more immediate, specific short-term military contingency, the risk of a war in the Taiwan Strait that would require China to engage in the U.S. military even while China's military remained seriously outgunned.

In short, by about 1996, the international situation looked pretty bleak from China's perspective and what could China's leaders do about it? The answer I would suggest has been the grand strategy or if you prefer a less grand term, the logic that has guided China's foreign policies in the years since, a strategy that aims to facilitate China's rise by reducing the likelihood that its growing capabilities will alarm others or provoke them to oppose China.

Let me briefly talk a bit about the main aspects of this strategy. How has its logic been translated into policy? Since mid-1996, China's leaders have centered their foreign policy around two broad efforts: first, they've embraced policies designed to reassure China's neighbors and to enhance the PRC's reputation as a more responsible and cooperative international actor.

Beijing's currency policy during the Asian financial crisis in the late 1990s was an early example of this effort. Of more enduring significance, however, has been China's active embrace of multilateralism since the mid-1990s that includes its central role in the Shanghai Cooperation Organization, its participation in attempts to work out a peaceful resolution of the nuclear crisis in Korea, and especially its multi-pronged effort to facilitate cooperation with the ASEAN countries of Southeast Asia.

The second broad component of China's grand strategy since the mid-'90s has been the regime's concerted effort to improve its bilateral relations with the world's other major powers in order to reduce the likelihood that they will unite to prevent China's slow but steady rise. By cultivating various types of partnerships, Beijing seeks to increase the benefits that other powers see in working with China and to underscore the cost of working against it.

These partnerships then are expected to establish a simple linkage. If China's great power partners opt to press Beijing on matters important enough to sour their relations with it and in particular over the matter of Taiwan, they will be jeopardizing important benefits they get such as economic opportunities for trade and investment in China as well as cooperation with Beijing in managing security problems such as weapons proliferation and terrorism.

Let me turn next in the short time I have left to talk about some of the implications of this grand strategy for the United States and an American policy towards China. First of all in itself China's current approach, which they have sometimes referred to as the strategy of peaceful rise or peaceful development, should raise few concerns.

Yet it's clear that this strategy is, in fact, a strategy for a period of transition—for the decades it will take for China to rise. What happens after China rises? Once it has amassed greater capabilities, will China demand changes in the international order that signal its arrival as a disruptive power determined to alter the international system to its advantage?

My answer, the short version anyway, is not only that we don't know, but that we simply can't know, at least not yet. That's a bit troubling because if we can't be sure how a more powerful China will behave, how can we sensibly deal with a rising China now and in the coming years? To my thinking, the key to a sensible policy in dealing with China is to recognize that for at least the next couple of decades, the areas of conflict between the United States and China, especially difficult economic problems that I know the Commission is interested in and even the potentially dangerous disagreements about Taiwan, are, in fact, manageable, not intractable problems.

Both China and the United States have important common interests in fighting terrorism, dealing with proliferation, coping with environmental degradation, addressing public health crises in a

globalized setting, that provide strong incentives for Beijing and Washington to work hard to manage those conflicts that prove unavoidable.

Conflicting interests in short do not yet swamp common interests in U.S.-China relations. There is time, at least a couple of decades, to learn whether a longer-term *modus vivendi* is possible. A sensible policy for the United States then is not only one under which the United States monitors what a rising China does, but also a policy that encourages China's responsible behavior whenever possible.

Now, there are, of course, no guarantees about how China will respond to a sensible U.S. approach, a U.S. approach of conditional cooperation or contingent cooperation. Some then might argue, well, isn't it better to be safe than sorry? Perhaps it would be wiser to take a hard line against China while it is weak.

For three reasons, I think that position is seriously misguided. First, it would undermine currently important U.S. interests. China would certainly reciprocate our hostility and that would make it much more difficult for us to address the many international problems on which Chinese cooperation is important.

Second, a policy designed to contain China and prevent its rise would be exceedingly difficult to implement. It would find little support from those countries whose support would be essential for such a strategy to succeed.

On the contrary, with a few exceptions, I think such an approach would most likely aggravate relations with many of our allies and partners around the world.

And third, and I think most importantly, urgent calls to deal now with the possible dangers China's rise might one day pose overstate the risks for the United States of responding as China acts, adjusting our approach to a rising in China as events warrant.

The U.S. holds huge advantages over China both in terms of hard and what is sometimes called soft power. There is no need for us to be stampeded into prematurely dealing with China as an adversary. China cannot become a great power overnight. Indeed, China's grand strategy that I referred to briefly here reflects its attempt to play a rather weak hand well. The United States by contrast holds most of the high cards. We need only be sure that we don't play our strong hand poorly, and I think a rush to judgment about the nature of the China we are likely to face several decades from now is not only unwise, it is also unnecessary.

Thank you.

[The statement follows:]

**Prepared Statement of Avery Goldstein
Professor of Political Science, University of Pennsylvania**

I thank the Commission for inviting me to share my views with it today. In my brief opening remarks, I cannot touch on all the specific issues I am sure the Commission will want to raise in this session. Instead, as requested in the letter of invitation I received, I will present my understanding of China's international objectives and the factors shaping China's global relations. My views are outlined in greater detail in my most recent book about China's grand strategy, *Rising to the Challenge: China's Grand Strategy and International Security* (Stanford: Stanford University Press, 2005), several chapters of which I have sent to the Commission's staff.

China's global relations today reflect a grand strategy whose central purpose is to enable the country to emerge as a true great power during the 21st century. The

elements of this strategy came together in the mid-1990s as the leaders in Beijing more clearly recognized the stiff international challenges they faced in pursuing this goal. I will begin by briefly explaining the origins of the strategy, next describe its basic features, and finally discuss some of its implications for U.S.-China relations and U.S. policy towards China.

I. China Settles on Its Strategy

Four factors explain why China embraced its current foreign policy approach in the mid-1990s.

1. *U.S. Strength.* By the mid-1990s, Chinese analysts recognized that, contrary to their belief when the Cold War ended, the world was not quickly going to become multipolar. Instead, unipolarity would last for decades with the U.S. remaining the world's sole superpower. As such, for the foreseeable future China would have to operate in a setting where the U.S. would have the ability to frustrate China's international ambitions.

2. *China's Weakness.* Although China's economic and military capabilities were growing as a result of the reform program in place since 1979, it still lagged far behind the world's leading states, especially the U.S. Perhaps most significantly, as China's leaders witnessed U.S. military operations during the 1990s, beginning with Operation Desert Storm in 1991, they more clearly recognized just how far they had to go before their armed forces were in the same league as the U.S. and its allies.

3. *Nervous International Reaction.* Even though China remained economically and militarily outclassed in the first half of the 1990s, its growing capabilities had already begun to prompt others to debate "China's rise" and led some to react in ways that could damage China's interests. In the U.S., there was new talk about a "China threat" and what might have to be done about it. Among China's immediate neighbors, especially those in Southeast Asia, there was new concern about China's assertive posture towards resolving maritime and territorial disputes and some wondered what this might portend about the role an even more powerful China would play in coming decades. Against this background, China's leaders were alarmed by Washington's efforts in the mid-1990s to update its Cold War vintage alliances with Australia and Japan, as well as enhanced U.S. military cooperation with the nations of Southeast Asia—trends that Beijing worried might be the beginnings of an American led regional effort to contain China.

4. *Taiwan Tensions.* In 1995–1996 China saw a challenge to its sovereignty claim over Taiwan from a new cohort of elected leaders on the island. When Beijing used military exercises to warn Taiwan about the risks of pursuing independence, Washington responded with its own naval maneuvers that clearly signaled a continued American interest in Taiwan's security and the likelihood of U.S. intervention if China used force to press its claim to Taiwan. This mini-crisis over Taiwan clarified for Beijing that in addition to long-term, hypothetical concerns about the U.S. and others frustrating China's rise to great power status, China had to worry about a more immediate, specific, short-term military contingency—the risk of a war in the Taiwan Strait that would require China to engage the U.S. military even while China's military remained distinctly outclassed.

In short, by about 1996, the international situation looked pretty bleak from China's perspective. What could Beijing's leaders do about it? Their answer has been the grand strategy, or the logic, that has guided China's foreign policies in the years since 1996. This grand strategy was not announced with a formal declaration, or even given a clear name. In the last few years, some in China did begin referring to their approach as the strategy of "peaceful rise" a term more recently shunned in favor of "peaceful development" (a shift in terminology for reasons of style rather than substance). Whatever label one uses to describe it, China has adopted a strategy that aims to facilitate China's rise by reducing the likelihood its growing capabilities will alarm others or provoke them to oppose China.

II. China's Grand Strategy

How has this strategic logic been translated into policy? Since mid-1996 China's leaders have centered their foreign policy around two broad efforts.

First, they have embraced policies designed to reassure China's neighbors and to enhance the PRC's reputation as a more responsible and cooperative international actor. Beijing's widely touted self-restraint during the wave of currency devaluations that accompanied the Asian financial crisis in the late 1990s was an early example of this effort. Of more enduring significance has been China's active embrace of multilateralism since the mid-1990s that includes its central role in the Shanghai Cooperation Organization, its participation in the attempt to work out a peaceful

resolution of the nuclear crisis on the Korean peninsula, and especially its multi-pronged effort to facilitate cooperation with the ASEAN countries of Southeast Asia.

Second, since 1996 China's leaders have been engaged in a concerted effort to improve bilateral relations with the world's other major powers in order to reduce the likelihood that they will unite to prevent China's slow but steady rise. By cultivating various types of partnerships, Beijing seeks to increase the benefits other great powers see in working with China *and* to underscore the opportunity costs of working against it. These partnerships are expected to establish a simple linkage: if China's great power partners opt to press Beijing on matters important enough to sour relations, they will jeopardize important benefits such as economic opportunities for trade and investment and cooperation in managing the security problems of weapons proliferation and terrorism.

In sum, then, the grand strategy that has guided China's foreign policy over the past decade emerged as a reaction to the stiff challenge Beijing faces as a relatively weak state, but one whose growing power and international aspirations already make others nervous and might lead them to oppose China. The combination of policies designed to cultivate China's reputation as a responsible international player and to nurture partnerships with major powers seeks to ensure an international context in which China has the opportunity to continue the decades-long process of modernization that will be necessary if it is to become a true great power.

III. Implications of China's Grand Strategy

In itself, China's current grand strategy, a strategy that seeks a "peaceful rise" or "peaceful development" raises few concerns. It is important, however, to recognize that this is explicitly a strategy for a period of transition, designed for the decades it will take China to rise. What happens after China rises? Will it continue to embrace the current policies that make it basically a responsible status quo power? Or, once it has amassed greater capabilities will China demand changes in the international order that signal its arrival as a disruptive, revisionist power determined to alter the international system to its advantage? Confronted with these important questions, Chinese officials and analysts typically assert that China will "never be a hegemon, never practice power politics, and never pose a threat to its neighbors or to world peace." Yet many analysts outside China respond to these questions with equally firm convictions, insisting a more powerful China will *inevitably* pose a threat to international peace and stability; they typically justify their view by drawing on a preferred theory about international relations or by citing examples of rising powers that caused trouble in the past.

Which of these contrasting views is closer to the truth? My answer is not only that we *don't* know, but that we simply *can't* know. At least not yet.

In looking to the future, the Chinese may very well be sincerely representing their peaceful intentions today. Nevertheless, they cannot possibly know how a Chinese government several decades from now will view their country's interests or how they will choose to respond to what will inevitably be a much different international situation. And in looking to the future, while foreign analysts are surely correct in pointing to persuasive academic theories about the disruptive potential of rising powers and in citing worrisome historical examples of them, there are also some academic theories and historical examples that suggest the rise of a new great power need not inevitably spell trouble.

IV. Uncertainty and Policy

If we cannot be sure about how a more powerful China will behave, how can we sensibly deal with a rising China in the coming years? The key to sensible policy in dealing with China is to recognize that we are in the midst of what the Chinese sometimes refer to as a "period of strategic opportunity." For at least the next couple of decades, the areas of conflict between the U.S. and China (especially difficult economic problems and even the potentially dangerous disagreement about Taiwan) are in fact manageable, not intractable, problems. And both China and the U.S. have important common interests (fighting terrorism, dealing with proliferation, coping with environmental degradation, and addressing public health crises in a globalized setting) that provide strong incentives for both Beijing and Washington to work hard to manage and contain bilateral conflicts. Because conflicting interests do not yet swamp common interests in U.S.-China relations, there is time, most likely a couple of decades, to learn whether a longer-term *modus vivendi* is possible. Each side will be drawing conclusions along the way. Time will provide the Chinese with the opportunity to learn whether the U.S. is willing to accept a larger international role for a more powerful China. Time will also provide the U.S. with the opportunity to learn whether China is in fact emerging as a responsible great power with which the U.S. can coexist without sacrificing American vital interests. A sen-

sible policy is not only one under which the U.S. seizes this “period of strategic opportunity” to monitor what China does, but also encourages China’s responsible behavior whenever possible.

There are, of course, no guarantees about how China will respond to a sensible U.S. approach of contingent cooperation. Others might well argue, then, that prudence requires us instead “to prepare for the worst,” that it is “better to be safe than sorry,” and that wisdom suggests it is wiser to take a hard line against China while it is still weak. For three reasons, I think that position is misguided.

First, it would undermine currently important U.S. interests; China would reciprocate our hostility and that would make it much more difficult for us to address the many international economic, environmental, and security problems on which Chinese cooperation is important.

Second, a policy designed to contain China and prevent its rise would be exceedingly difficult to implement. Unlike the U.S. effort to contain the former Soviet Union, an attempt to contain China would find little support from the countries whose support is essential for such a strategy to succeed. On the contrary, with a few exceptions, such an approach would most likely aggravate relations with many American allies and partners around the world.

Third, and most importantly, urgent calls to deal now with the possible dangers China’s rise might one day pose, overstate the risks for the U.S. of waiting and watching, responding as China acts, and adjusting our approach towards a rising China as events warrant. The U.S. holds huge advantages over China, both in hard and soft power. There is no need to be stampeded into prematurely dealing with China as an adversary. China cannot become a great power overnight; it will be a rising power for several decades and will only emerge as a great power if it succeeds in overcoming some very daunting domestic obstacles to modernization. China has adopted the grand strategy I described because it recognizes just how weak it is relative to the U.S. and its allies. As such, China’s strategy reflects its attempt to play a weak hand well. The U.S., by contrast, holds most of the high cards; we need only be sure that we don’t play our strong hand poorly. A rush to judgment about the nature of the China we are likely to face several decades from now is not only unwise, it is also unnecessary.

Cochair BARTHOLOMEW. Thank you, Dr. Goldstein. Dr. McMillion.

**STATEMENT OF CHARLES W. McMILLION
PRESIDENT AND CHIEF ECONOMIST, MBG INFORMATION SERVICES**

Dr. McMILLION. Madam Chair, and other Commissioners, thank you for inviting me this afternoon. I want to use my few minutes to quantify some of the superlatives that we’ve heard today, go beyond the “oh-gosh-gee-whiz” that we so often hear.

I’d like to do that in an effort to focus on three points. The first is that during its wildly successful Tenth Five Year Development Plan from the Year 2000 to 2005, China has accumulated money, technology and productive capacity at a pace that has never been seen before and was unimaginable just a few years ago. I was guilty of that myself.

The second is that this rapid development creates its own dynamic which together with an even more powerful and sophisticated 11th Five Year Plan that starts this coming January will have an ever stronger influence on the location and the nature of global production, research and development and vital technical standards. I hope we can talk about technical standards at some point during the session today.

And thirdly, thus far, the United States has proven to be uniquely capable of borrowing or selling assets to accommodate China’s rapid rise in commercial influence. However, with a population much smaller than China’s, and vastly higher production costs, the United States can sustain its living standards and its military security only if it retains vastly superior technology within its borders, and it’s the within its borders that I think is particularly important.

This is now threatened, I believe, by China's rapidly growing global commercial influence. Now, I know this isn't everybody's favorite thing, but I'd like to quickly race through a little packet of graphics and tables, which I hope you have in your briefing book, and I apologize to the others in the audience that as an accommodation for not having PowerPoint, we are doing it this way, and I apologize.

The first graphic that—this happens to be from the CIA, but it's the typical purchasing power parity list of ten major economies in the world. It shows at purchasing power parity, that China's economy is over \$6 trillion. Of course, at 8.27 yuan to the dollar—today's not exactly market rate—the Chinese economy is about 1.5 trillion.

So the first thing is to recognize that at least at purchasing power parity terms, China's economy is already the second largest in the world and it again provides enormous incentive for investment and production in China. This is what I indicated earlier about providing its own momentum independent of policy.

The other important aspect, of course, of this difference between the \$1.5 trillion economy at so-called market rate, at fixed rate, and the other \$6 trillion at purchasing power parity rate, is that this implies, this PPP rate, implies a yuan to the dollar exchange rate of about two. In other words, 75 percent more than the current rate.

PPPs used to be what we used when we had fixed exchange rates as a way of evaluating where a currency should be. I don't want to overplay this today, but you might consider this when next discussing the current value of the yuan and proposals that it might be ten to 27 or even 40 percent undervalued.

Next, I just wanted to indicate that the yuan was actually valued at two to the dollar about 20 years ago before a series of very rapid devaluations. Then, and again, we're going to have to race through this very quickly. I hope maybe we can discuss some of this later, but we do talk about "gee-whiz" and what an incredible rapid rise China has had in the last decade or so. The next chart demonstrates what we all know, I guess, is that despite the rapid rate of growth in the United States during the 1990s, which by the way still wasn't as rapid as world growth, but despite the rapid growth in the U.S. in the 1990s, China grew three times our rate in the 1990s, and so far in the 21st century, China's real GDP is growing closer to four times our rate.

One of the reasons for graphics like this, is to dramatize the rapid pace of acceleration in China just during this Tenth Five Year Plan, the last five years.

So the next chart shows the current account trade balances which China has had a surplus, unlike India. China has a surplus in goods and services trade and their current accounts for quite a long time, but beginning in 2002, that began to accelerate at a very rapid rate and China may have a current account surplus this year of close to \$100 billion.

Last year, it was about 70 billion. This year close to 100 billion dollars. The next issue that's begun to get a little bit of attention lately is the just astonishingly rapid rate that China is building up

their foreign currency reserves, about \$50 billion a quarter for the last eight quarters.

They currently have as of the end of the second quarter this year \$711 billion in foreign currency reserve. They could easily end the year at over 800 billion dollars. They could end next year very close to a trillion dollars and pass Japan, which for other reasons is the one other country that has been rapidly accumulating these foreign currency reserves so that they can support their currency, but can do any number of other things with that sort of money.

Next, is a chart that demonstrates graphically how rapidly our goods balances declined with China even with all of our various agreements. I see that my time is running out. Let me just race to the end of this and show the trade balance with China throughout our various industries.

I wanted to show the technology balance, but maybe we can get into that in the Q&A. Just since 1990, the U.S. has accumulated a trade deficit. We've transferred over \$800 billion in wealth to China. This is what the Congressman was referring to earlier. And this year, of course, it could be close to 200 billion dollars, so at the end of this year, in rough terms, we will have had a trade deficit with China since 1990 of roughly a trillion dollars, and as this table at the end of my presentation shows, it is very broadly distributed among most, virtually all manufacturing industries, and particularly among high technology manufacturing industries other than aircraft.

Thank you very much.

[The statement follows:]

**Prepared Statement of Charles W. McMillion
President and Chief Economist, MBG Information Services**

Madam Chair and Commissioners, thank you for inviting me to testify on this extraordinarily important concern. As some of you know, I've followed these matters with great interest for almost 25 years. I am therefore tempted to filibuster today but I've pledged to keep my remarks to seven minutes. So please forgive me that I start without the usual pleasantries and race through only a few highlights from my full testimony of economic data and analyses. I do ask that my full testimony be entered into the hearing record.

I hope to focus your attention on three major issues:

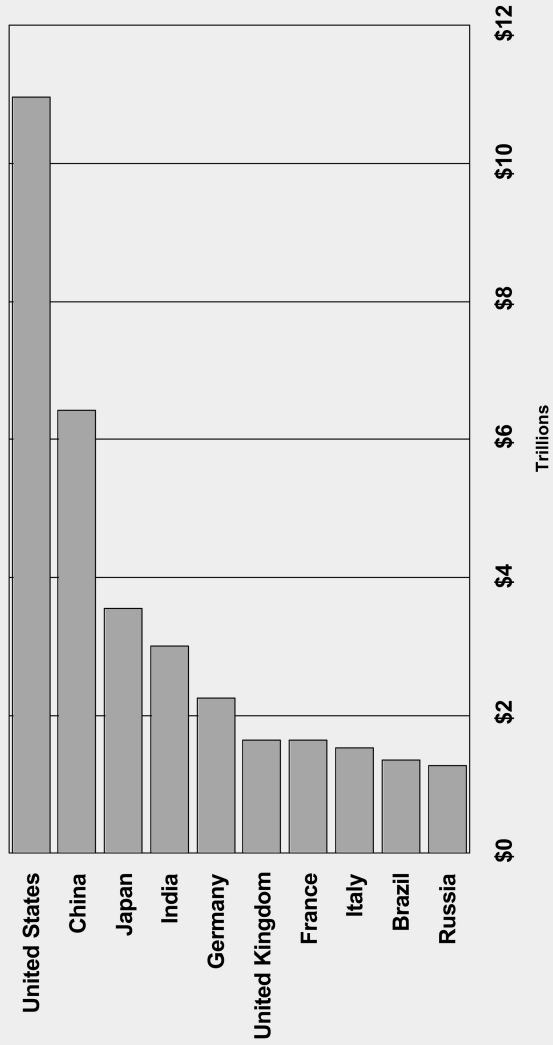
- (1) During its wildly successful 10th Five Year Development Plan from 2000 to 2005, China has been accumulating money, technology and productive capacity at a pace that has never been seen before and was unimaginable just a few years ago.
- (2) This rapid development creates its own dynamic which, together with an even more powerful and sophisticated 11th Five Year Plan starting in January, will have an ever-stronger influence on the location and the nature of global production, R&D and vital technical standards.
- (3) Thus far, the U.S. has proven to be uniquely capable of borrowing or selling assets to accommodate China's rapid rise in commercial influence. However, with a far smaller population and vastly higher production costs, the U.S. can sustain its living standards and its military security only if it retains vastly superior technology within its borders; this is now threatened by China's rapidly growing global commercial influence.

Now, I would like to move quickly through a few highlights from my analysis of the economic data and look forward to the discussion to follow.

Dr. Charles W. McMillion is president and chief economist of MBG Information Services in Washington, D.C. He is a former professor and associate director in the Johns Hopkins University policy institute and a former contributing editor of the *Harvard Business Review*. He helped to establish the bipartisan and bicameral Congressional Competitiveness Caucus in the mid-1980s and is a founder of the Congressional Economic Leadership Institute. He can be reached at 202-544-6490 or at "CWM@MBGInfoSvcs.COM."

China: The World's Second Largest Economy In Terms of Purchasing Power Parity

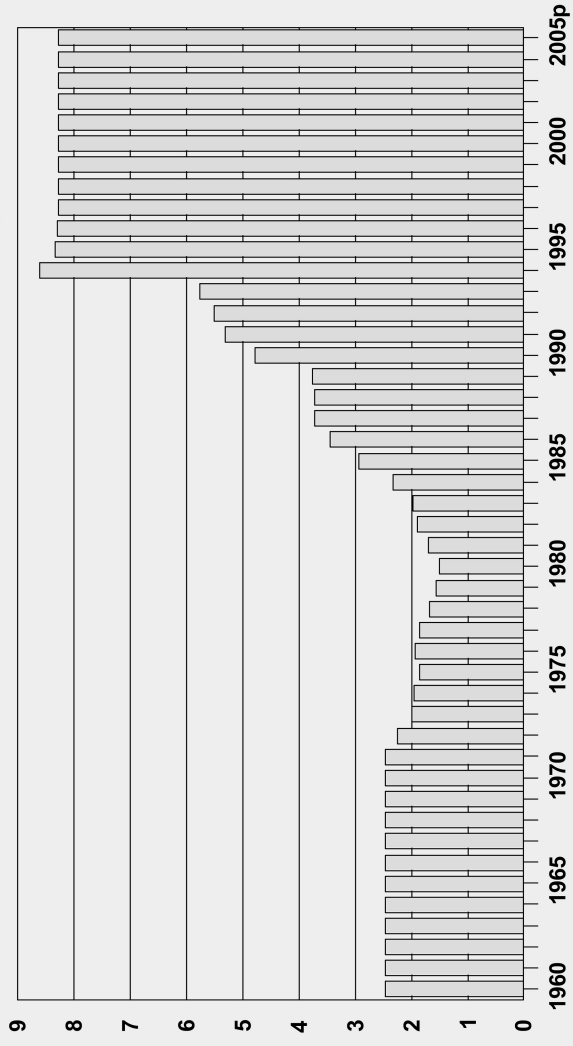
\$ Trillions of Dollars in 2003: Purchasing Power Parity



US Central Intelligence Agency and MBG Information Services

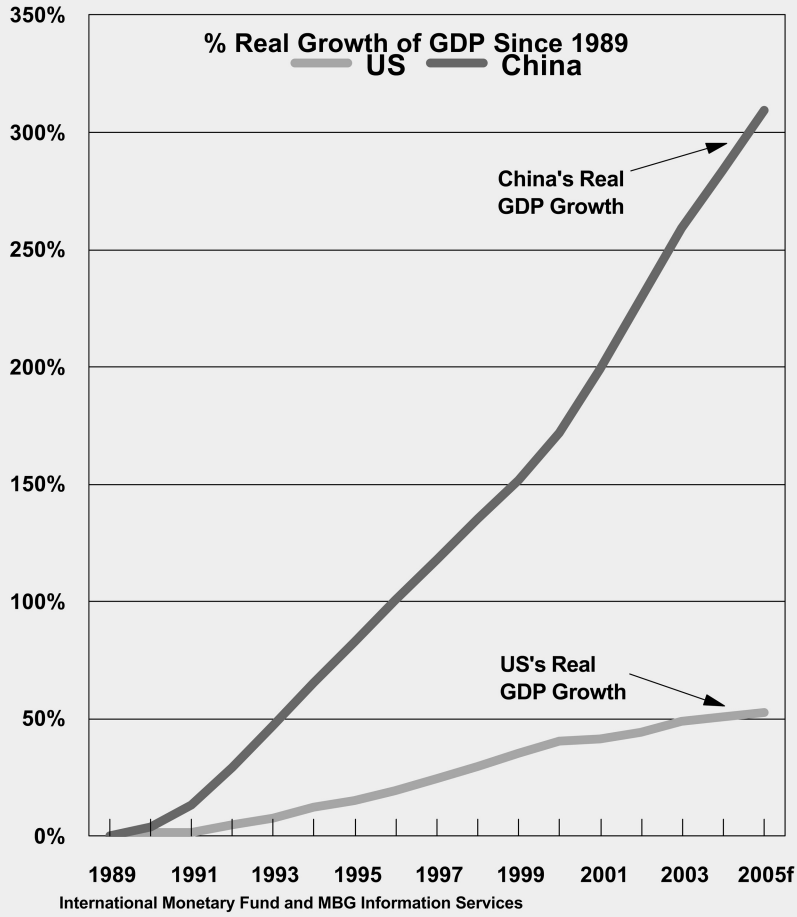
The Dollar/Yuan Exchange Rate: China Devalued the Yuan Sharply in 1994

Chinese Yuan Per US Dollar: Annual Averages



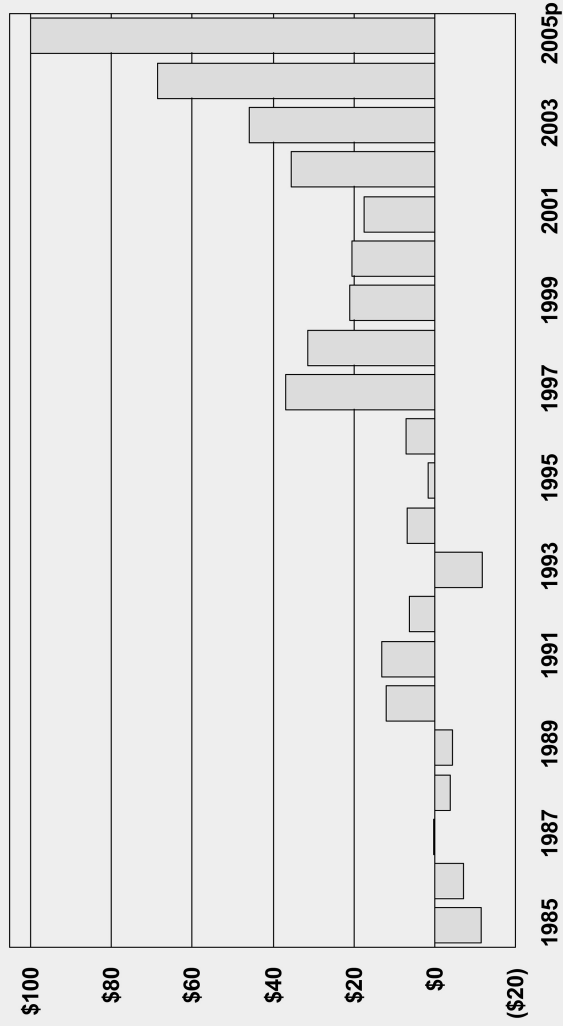
International Monetary Fund and MGB Information Services

Economic Growth During Last 15 Years China's Growth Far Exceeds US Rate



China's Current Account Trade Balances: Large Surpluses Only Since 1997 are Soaring Now

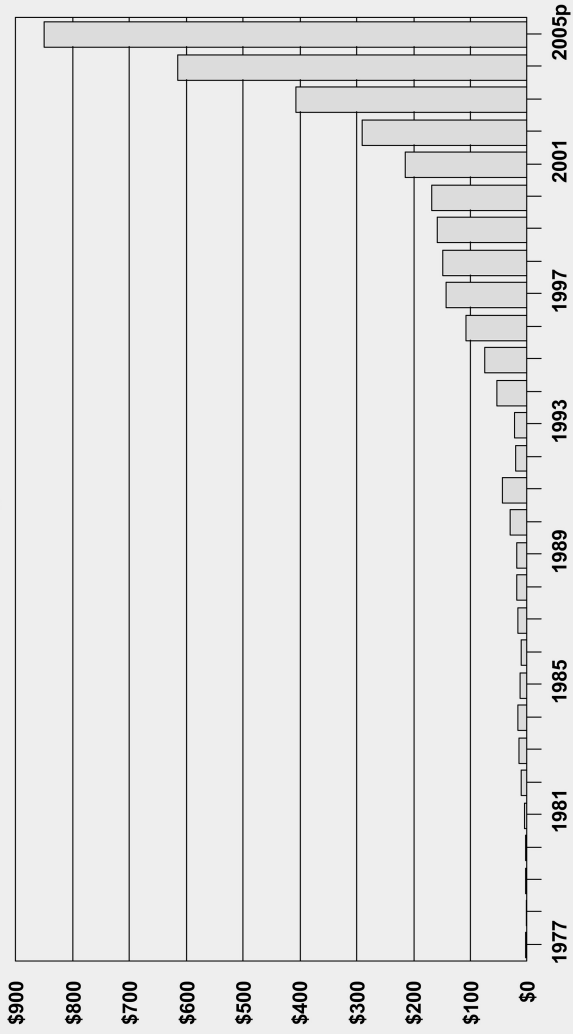
\$ Billions: Annual Current Account Trade Balance



International Monetary Fund and MBG Information Services 2005 surplus projected from yr-to-May goods trade data

China's Foreign Reserves Are Soaring: Total Reserves Tripled from 2001 to 2004

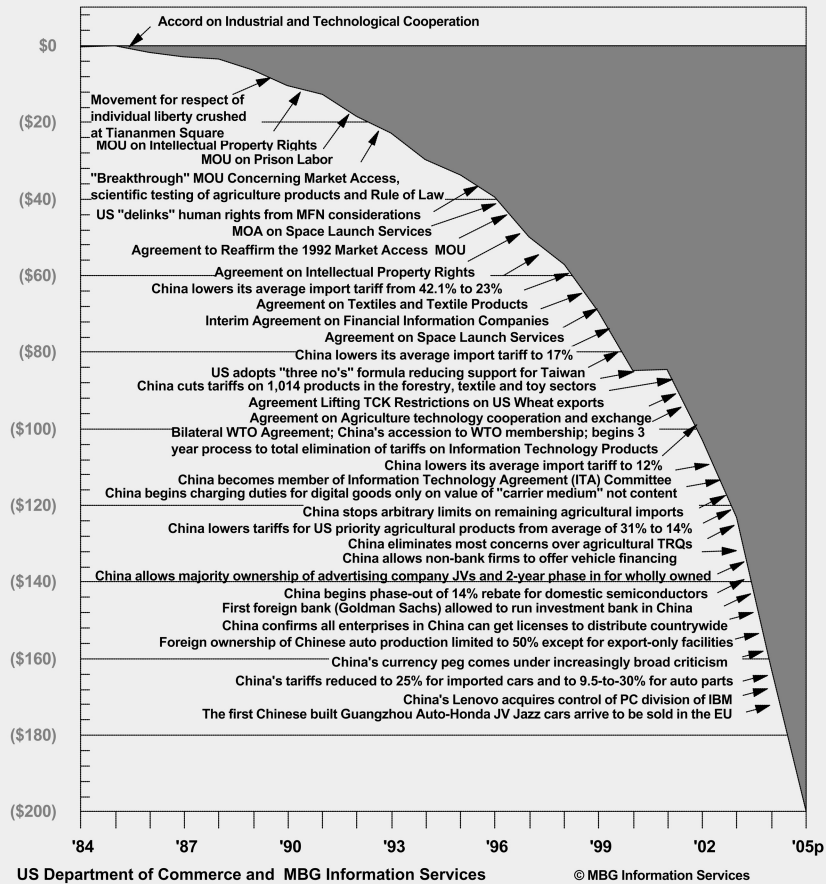
\$Billion: China's Foreign Reserves Less Gold



International Monetary Fund and MBG Information Services

US Goods Trade Balance With China: Tariff Cuts, Agreements, 20 Years of MFN, WTO and Accelerating Collapse

\$ Billions Per Year: US Merchandise Net Exports



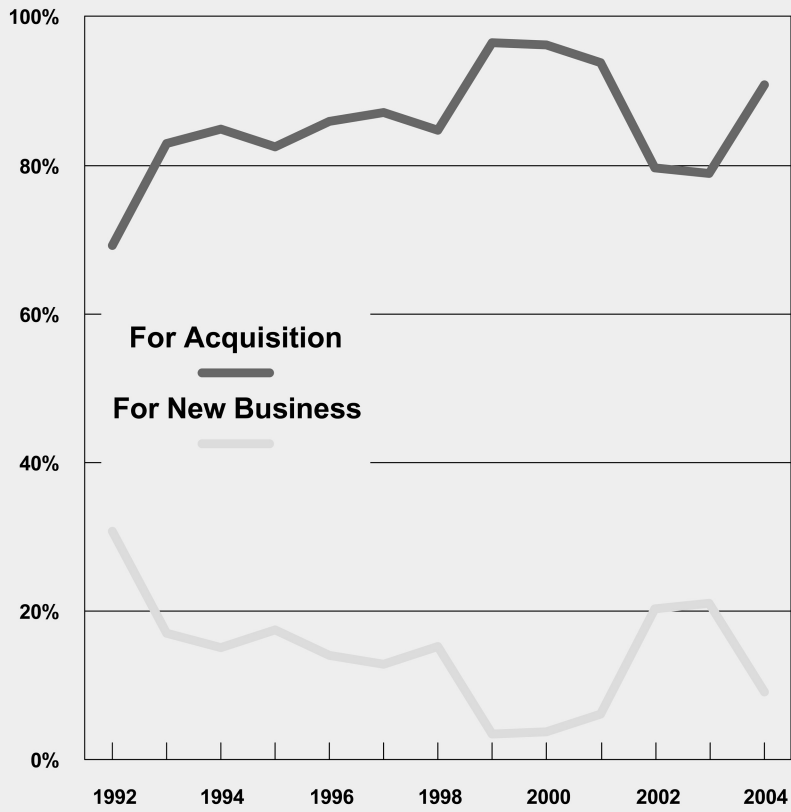
Worst Ever US Losses in Current Accounts

\$ Billion: US Quarterly Balances in All Global Current Accounts

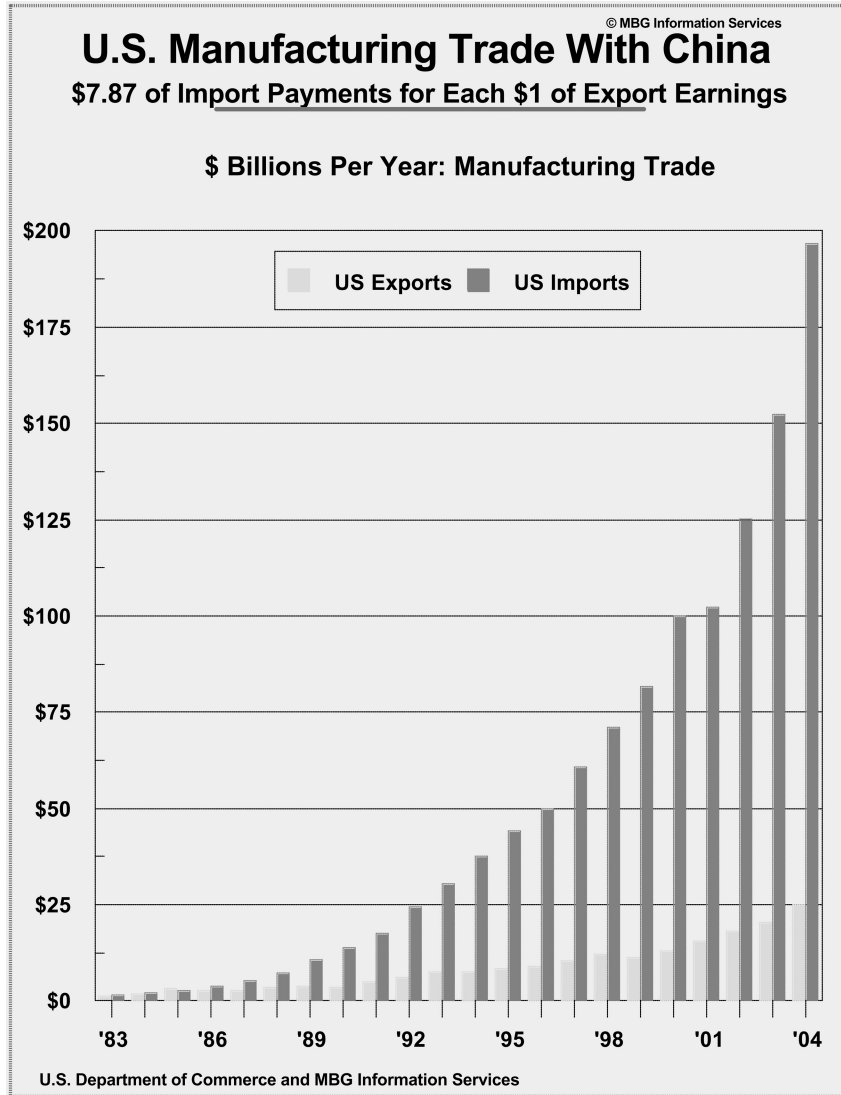


Foreign Direct Investment in the US: 90%+ for Acquisition of Existing Worldwide Assets

\$ Billion in Annual FDI Into the US

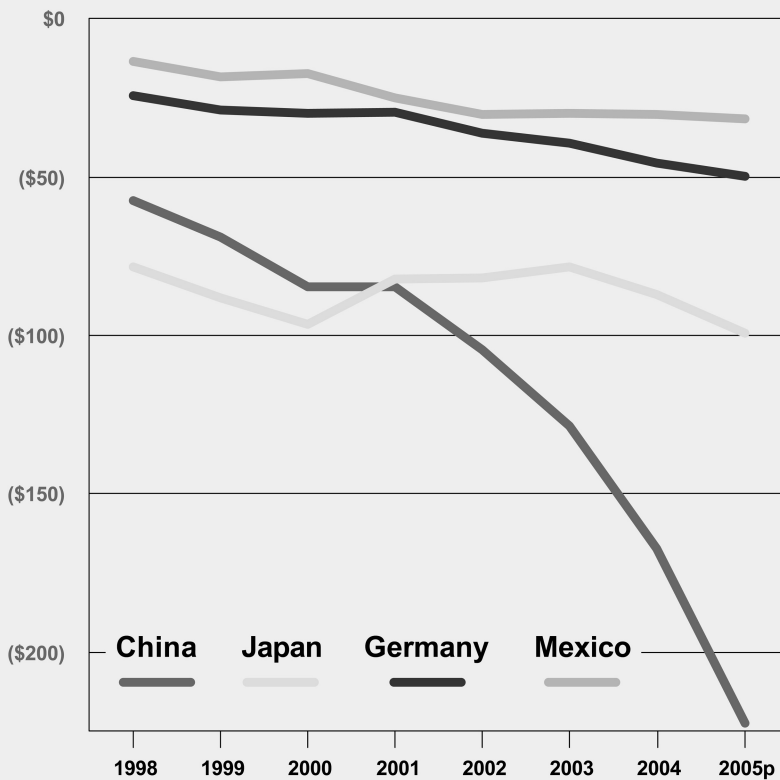


US Dept. of Commerce and MBG Information Services



US Trade of Manufactured Goods: Trade With China Has Become The Worst Deficit

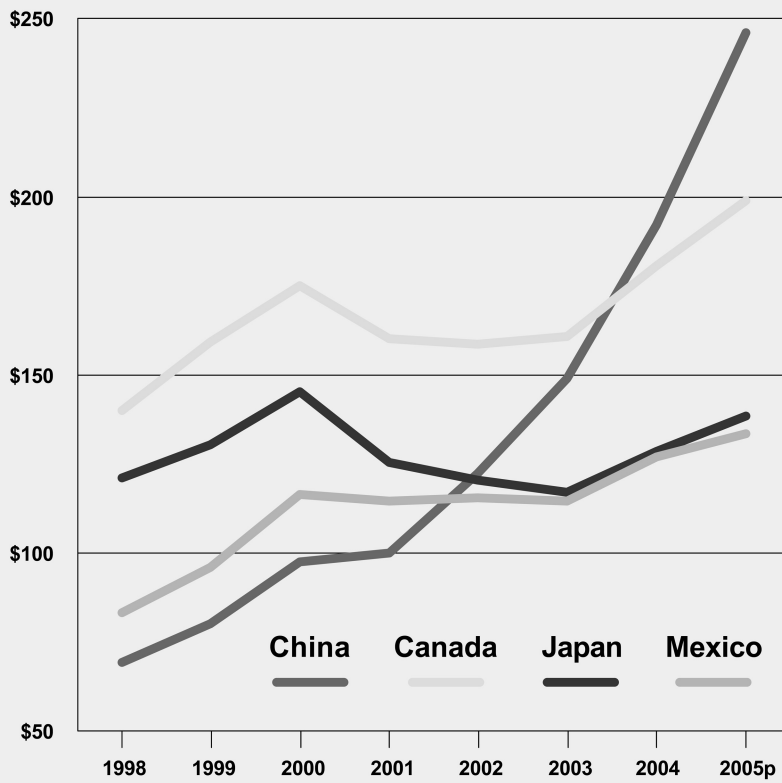
\$Billions: US Manufactured Goods Trade Balances



US Dept. of Commerce and MBG Information Services 2005 is projected from yr-to-April

US Import of Manufactured Goods: China Has Rocketed To Become The Top Supplier

\$Billions: Manufactured Goods Imports Into the US

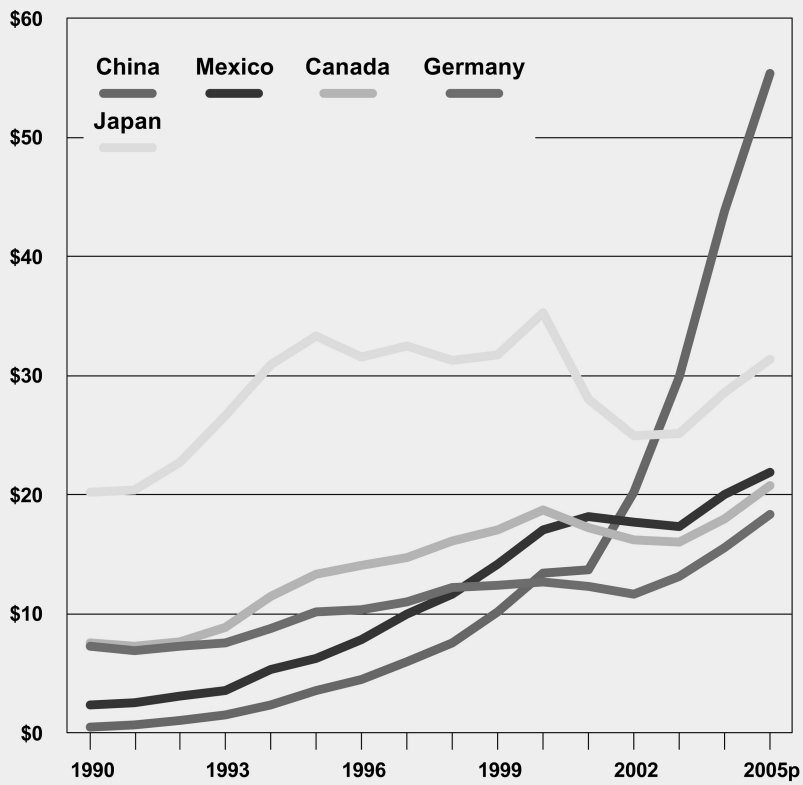


US Dept. of Commerce and MBG Information Services 2005 is projected from yr-to-April

US Imports of Machinery: HS84

Imports From China Have Rocketed Since WTO

\$Billions: US Non-Electrical Machinery Imports

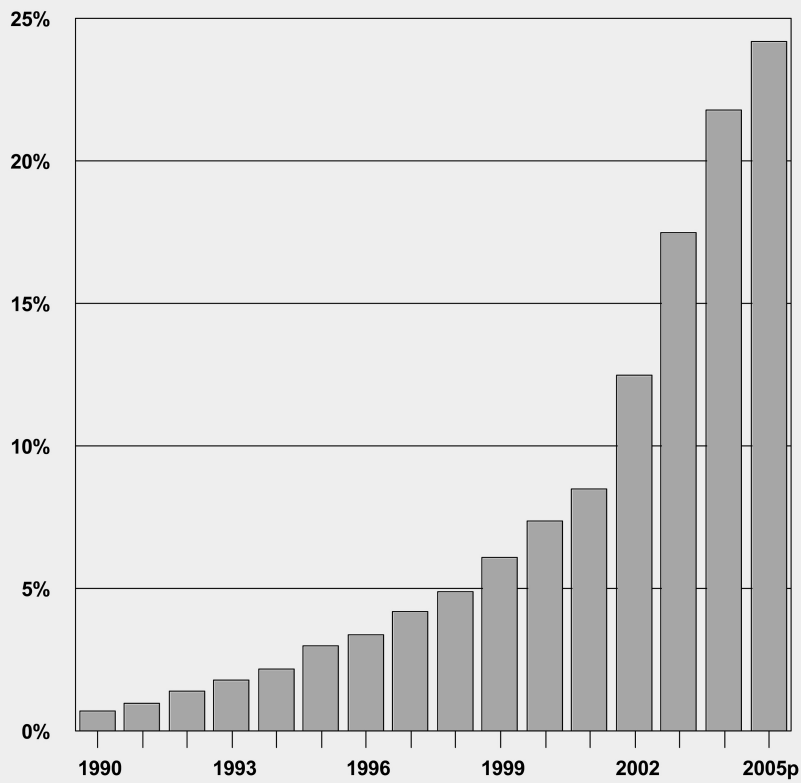


US Dept. of Commerce and MBG Information Services 2005 is projected from yr-to-April

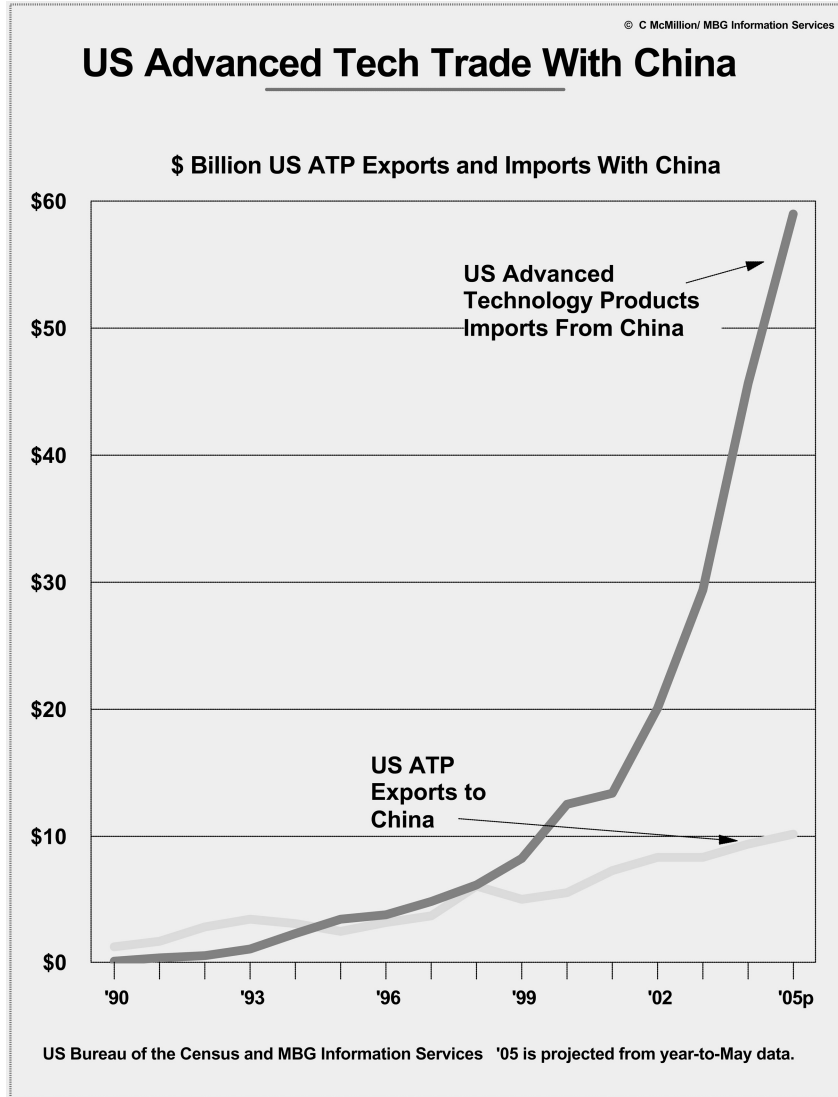
US Imports of Machinery: HS84

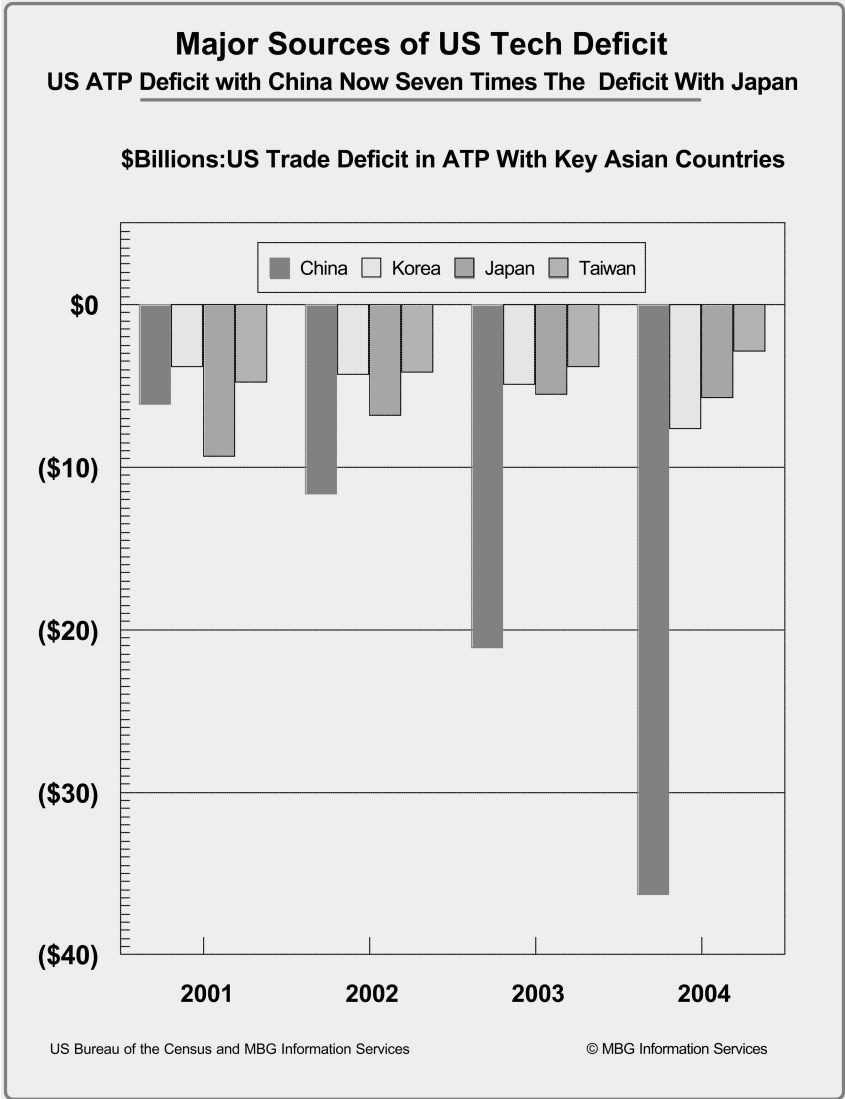
Imports From China Have Rocketed Since WTO

% of All US Non-Electrical Machinery Imports from China



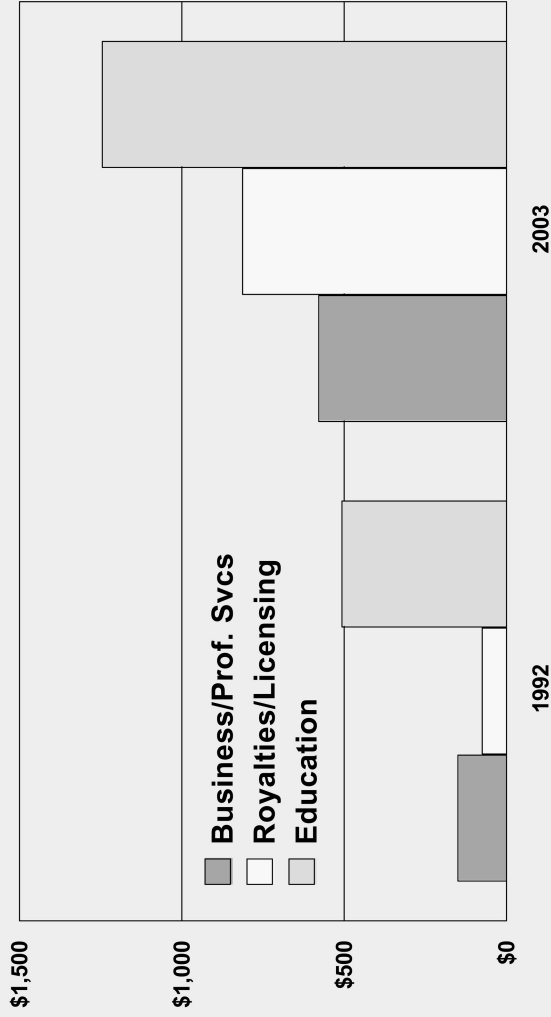
US Dept. of Commerce and MBG Information Services 2005 is projected from yr-to-April





**US Surplus in Services Trade With China Remains Small:
Total Surplus: \$515 Million in 1992 rose to \$2.06 Billion in 2003**

\$ Millions: US Balances in Services Trade with China

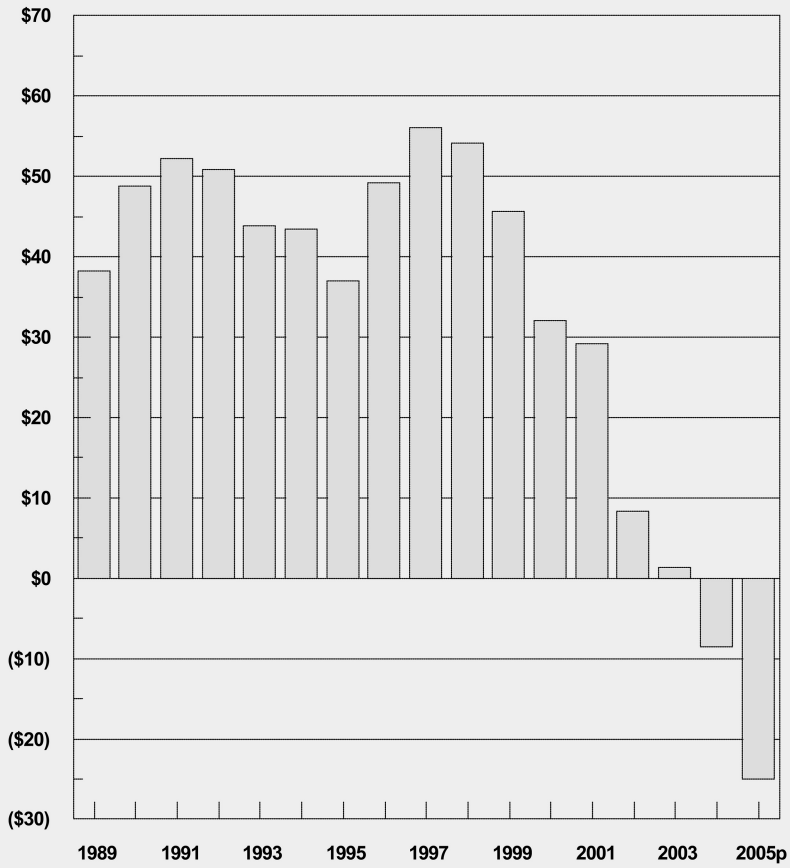


US Dept. of Commerce, BEA and MBG Information Services

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US Trade in Advanced Technology & IP

First Recorded Deficit in Tech Goods, Royalties and Fees



US Bureau of the Census and MBG Information Services

© MBG Information Services

China Trade: All 50 States Have Deficits, Most Worsening Rapidly							
© MBG Information Services							
Merchandise (\$1,000)	----- 2003 -----			----- 2004 -----			'04 Ratio Im/Expts
	Exports	Imports*	Balance	Exports	Imports*	Balance	
United States	\$28,418,493	\$152,436,097	(\$124,017,604)	\$34,721,008	\$196,698,977	(\$161,977,969)	5.7
California.....	5,465,042	18,632,419	(13,167,377)	6,841,775	23,988,114	(17,146,339)	3.5
New York.....	1,445,174	9,980,754	(8,535,580)	1,877,184	12,995,900	(11,118,716)	6.9
Florida.....	649,474	9,030,841	(8,381,367)	544,653	11,498,790	(10,954,137)	21.1
Texas.....	3,059,559	11,674,538	(8,614,979)	4,455,739	14,951,430	(10,495,691)	3.4
Illinois.....	794,203	6,599,629	(5,805,426)	922,952	8,556,248	(7,633,296)	9.3
Pennsylvania.....	564,996	6,440,088	(5,875,092)	780,724	8,367,979	(7,587,255)	10.7
Ohio.....	643,691	5,948,356	(5,304,665)	963,589	7,736,813	(6,773,224)	8.0
Michigan.....	366,702	5,249,446	(4,882,744)	607,157	6,820,034	(6,212,877)	11.2
New Jersey.....	502,168	4,515,576	(4,013,408)	578,506	5,846,004	(5,267,498)	10.1
Georgia.....	644,199	4,583,320	(3,939,121)	801,370	5,869,035	(5,067,665)	7.3
North Carolina.....	649,263	4,433,736	(3,784,473)	648,447	5,696,363	(5,047,916)	8.8
Virginia.....	521,175	3,872,385	(3,351,210)	608,378	4,982,114	(4,373,736)	8.2
Indiana.....	235,552	3,237,913	(3,002,361)	294,385	4,193,588	(3,899,203)	14.2
Maryland.....	193,955	2,885,180	(2,691,225)	223,870	3,728,703	(3,504,833)	16.7
Missouri.....	260,181	2,987,214	(2,727,033)	365,959	3,868,653	(3,502,694)	10.6
Massachusetts.....	571,802	3,330,798	(2,758,996)	874,856	4,342,935	(3,468,079)	5.0
Arizona.....	741,260	2,981,616	(2,240,356)	628,996	3,773,964	(3,144,968)	6.0
Wisconsin.....	548,228	2,859,727	(2,311,499)	583,303	3,702,985	(3,119,682)	6.3
Minnesota.....	377,559	2,647,900	(2,270,341)	409,131	3,425,568	(3,016,437)	8.4
Tennessee.....	636,172	3,063,181	(2,427,009)	1,213,641	3,953,886	(2,740,245)	3.3
Colorado.....	213,248	2,388,582	(2,175,334)	356,218	3,076,165	(2,719,947)	8.6
Alabama.....	355,756	2,351,611	(1,995,855)	389,077	3,046,465	(2,657,388)	7.8
Kentucky.....	236,425	2,152,142	(1,915,717)	317,337	2,785,675	(2,468,338)	8.8
South Carolina.....	286,945	2,179,211	(1,892,266)	480,936	2,806,343	(2,325,407)	5.8
Oklahoma.....	64,579	1,829,071	(1,764,492)	84,003	2,371,888	(2,287,885)	28.2
Connecticut.....	157,423	1,818,716	(1,661,293)	204,501	2,358,691	(2,154,190)	11.5
Iowa.....	92,955	1,533,651	(1,440,696)	128,292	1,990,047	(1,861,755)	15.5
Mississippi.....	109,409	1,506,925	(1,397,516)	116,014	1,949,879	(1,833,865)	16.8
Arkansas.....	141,452	1,428,886	(1,287,434)	90,697	1,845,154	(1,754,457)	20.3
Kansas.....	175,806	1,419,995	(1,244,189)	210,500	1,843,133	(1,632,633)	8.8
Oregon.....	574,875	1,865,944	(1,291,069)	791,038	2,411,027	(1,619,989)	3.0
Nevada.....	24,387	1,211,976	(1,187,589)	47,066	1,516,701	(1,469,635)	32.2
Utah.....	114,031	1,240,147	(1,126,116)	123,012	1,591,049	(1,468,037)	12.9
West Virginia.....	132,576	942,348	(809,772)	128,681	1,225,316	(1,096,635)	9.5
Nebraska.....	84,125	906,976	(822,851)	87,738	1,175,284	(1,087,546)	13.4
Washington.....	3,211,196	3,220,377	(9,181)	3,094,408	4,147,406	(1,052,998)	1.3
New Mexico.....	206,759	987,995	(781,236)	220,975	1,270,720	(1,049,745)	5.8
Louisiana.....	2,117,340	2,344,130	(226,790)	2,194,433	3,039,659	(845,226)	1.4
Hawaii.....	12,876	655,538	(642,662)	33,941	844,698	(810,757)	24.9
Maine.....	78,307	683,784	(605,477)	112,885	885,588	(772,703)	7.8
New Hampshire.....	73,267	674,569	(601,302)	101,866	871,721	(769,855)	8.6
Idaho.....	106,582	723,240	(616,658)	170,478	924,706	(754,228)	5.4
Rhode Island.....	35,816	560,955	(525,139)	45,822	727,898	(682,076)	15.9
Montana.....	10,249	481,134	(470,885)	15,367	621,071	(605,704)	40.4
South Dakota.....	10,425	400,164	(389,739)	29,728	517,406	(487,678)	17.4
Delaware.....	76,382	431,041	(354,659)	75,308	553,434	(478,126)	7.3
North Dakota.....	5,741	329,298	(323,557)	10,021	428,452	(418,431)	42.8
District of Columbia.....	2,113	287,333	(285,220)	9,145	377,192	(368,047)	41.2
Vermont.....	31,904	322,565	(290,661)	83,105	418,943	(335,838)	5.0
Wyoming.....	20,688	262,938	(242,250)	13,513	339,644	(326,131)	25.1
Alaska.....	153,860	340,235	(186,375)	241,502	438,517	(197,015)	1.8

* US imports are allocated to states according to each state's share of US population

Dept. of Commerce and MBG Information Services

State Jobs Displaced by China Goods Trade: 2004

	States: Adjusted for 5.6% Productivity Gain		\$1,000s China Trade Deficit/Surplus		Total Jobs Lost to China Deficit		Job Loss/Gain
	2003	2004	2003	2004	2003	2004	2004
US Totals.....	(\$124,017,604)	(\$161,977,969)	(1,116,158)	(1,376,813)			(260,654)
California.....	(13,167,377)	(17,146,339)	(118,506)	(145,744)			(27,237)
New York.....	(8,535,580)	(11,118,716)	(76,820)	(94,509)			(17,689)
Florida.....	(8,381,367)	(10,954,137)	(75,432)	(93,110)			(17,678)
Texas.....	(8,614,979)	(10,495,691)	(77,535)	(89,213)			(11,679)
Illinois.....	(5,805,426)	(7,633,296)	(52,249)	(64,883)			(12,634)
Pennsylvania.....	(5,875,092)	(7,587,255)	(52,876)	(64,492)			(11,616)
Ohio.....	(5,304,665)	(6,773,224)	(47,742)	(57,572)			(9,830)
Michigan.....	(4,882,744)	(6,212,877)	(43,945)	(52,809)			(8,865)
New Jersey.....	(4,013,408)	(5,267,498)	(36,121)	(44,774)			(8,653)
Georgia.....	(3,939,121)	(5,067,665)	(35,452)	(43,075)			(7,623)
North Carolina.....	(3,784,473)	(5,047,916)	(34,060)	(42,907)			(8,847)
Virginia.....	(3,351,210)	(4,373,736)	(30,161)	(37,177)			(7,016)
Indiana.....	(3,002,361)	(3,899,203)	(27,021)	(33,143)			(6,122)
Maryland.....	(2,691,225)	(3,504,833)	(24,221)	(29,791)			(5,570)
Missouri.....	(2,727,033)	(3,502,694)	(24,543)	(29,773)			(5,230)
Massachusetts.....	(2,758,996)	(3,468,079)	(24,831)	(29,479)			(4,648)
Arizona.....	(2,240,356)	(3,144,968)	(20,163)	(26,732)			(6,569)
Wisconsin.....	(2,311,499)	(3,119,682)	(20,803)	(26,517)			(5,714)
Minnesota.....	(2,270,341)	(3,016,437)	(20,433)	(25,640)			(5,207)
Tennessee.....	(2,427,009)	(2,740,245)	(21,843)	(23,292)			(1,449)
Colorado.....	(2,175,334)	(2,719,947)	(19,578)	(23,120)			(3,542)
Alabama.....	(1,995,855)	(2,657,388)	(17,963)	(22,588)			(4,625)
Kentucky.....	(1,915,717)	(2,468,338)	(17,241)	(20,981)			(3,739)
South Carolina.....	(1,892,266)	(2,325,407)	(17,030)	(19,766)			(2,736)
Oklahoma.....	(1,764,492)	(2,287,885)	(15,880)	(19,447)			(3,567)
Connecticut.....	(1,661,293)	(2,154,190)	(14,952)	(18,311)			(3,359)
Iowa.....	(1,440,696)	(1,861,755)	(12,966)	(15,825)			(2,859)
Mississippi.....	(1,397,516)	(1,833,865)	(12,578)	(15,588)			(3,010)
Arkansas.....	(1,287,434)	(1,754,457)	(11,587)	(14,913)			(3,326)
Kansas.....	(1,244,189)	(1,632,633)	(11,198)	(13,877)			(2,680)
Oregon.....	(1,291,069)	(1,619,989)	(11,620)	(13,770)			(2,150)
Nevada.....	(1,187,589)	(1,469,635)	(10,688)	(12,492)			(1,804)
Utah.....	(1,126,116)	(1,468,037)	(10,135)	(12,478)			(2,343)
West Virginia.....	(809,772)	(1,096,635)	(7,288)	(9,321)			(2,033)
Nebraska.....	(822,851)	(1,087,546)	(7,406)	(9,244)			(1,838)
Washington.....	(9,181)	(1,052,998)	(83)	(8,950)			(8,868)
New Mexico.....	(781,236)	(1,049,745)	(7,031)	(8,923)			(1,892)
Louisiana.....	(226,790)	(845,226)	(2,041)	(7,184)			(5,143)
Hawaii.....	(642,662)	(810,757)	(5,784)	(6,891)			(1,107)
Maine.....	(605,477)	(772,703)	(5,449)	(6,568)			(1,119)
New Hampshire.....	(601,302)	(769,855)	(5,412)	(6,544)			(1,132)
Idaho.....	(616,658)	(754,228)	(5,550)	(6,411)			(861)
Rhode Island.....	(525,139)	(682,076)	(4,726)	(5,798)			(1,071)
Montana.....	(470,885)	(605,704)	(4,238)	(5,148)			(911)
South Dakota.....	(389,739)	(487,678)	(3,508)	(4,145)			(638)
Delaware.....	(354,659)	(478,126)	(3,192)	(4,064)			(872)
North Dakota.....	(323,557)	(418,431)	(2,912)	(3,557)			(645)
District of Columbia.....	(285,220)	(368,047)	(2,567)	(3,128)			(561)
Vermont.....	(290,661)	(335,838)	(2,616)	(2,855)			(239)
Wyoming.....	(242,250)	(326,131)	(2,180)	(2,772)			(592)
Alaska.....	(186,375)	(197,015)	(1,677)	(1,675)			3

Depts. of Labor, Commerce; MBG Information Services calculations © MBG Information Services
 "www.MBGInfoSvc.com" State imports allocated as % of total US population in each year.

The World's Most Unequal Trading Relationship: US Trade With China

From 1995 - 2004, US Payments for Imports Exceed Earnings From Exports By \$805 Billion

HS Industry Codes: \$Millions	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Totals 1995-'04
05 Products Of Animal Origin, Neso	(\$43)	(\$57)	(\$73)	(\$65)	(\$77)	(\$96)	(\$94)	(\$150)	(\$131)	(\$159)	(\$181)	(\$219)	(\$1,246)
34 Soap Etc.; Lubricating Products; Waxes, Polishing	(14)	(29)	(50)	(63)	(66)	(90)	(122)	(140)	(133)	(164)	(169)	(196)	(1,194)
33 Essential Oils And Resinoids; Perfumery, Cosmetic	(21)	(26)	(42)	(34)	(31)	(61)	(74)	(86)	(132)	(164)	(165)	(185)	(974)
36 Explosives; Pyrotechnic Products; Matches; Pyropt	(73)	(76)	(78)	(92)	(95)	(106)	(128)	(118)	(130)	(141)	(171)	(176)	(1,234)
97 Works Of Art, Collectors' Pieces And Antiques	(70)	(54)	(50)	(93)	(79)	(147)	(156)	(162)	(153)	(149)	(161)	(158)	(1,307)
43 Furskins And Artificial Fur; Manufactures Thereof	(28)	(38)	(27)	(40)	(45)	(42)	(41)	(73)	(87)	(91)	(118)	(138)	(702)
07 Edible Vegetables And Certain Roots And Tubers	(48)	(44)	(38)	(35)	(37)	(49)	(56)	(45)	(55)	(63)	(89)	(126)	(612)
56 Special Woven Fabrics; Tufted Textile Fabrics; Lac	(29)	(31)	(31)	(36)	(65)	(53)	(48)	(51)	(49)	(70)	(95)	(120)	(618)
81 Base Metals Neso; Cermet; Articles Thereof	9	12	(22)	3	(7)	(28)	(42)	(45)	(24)	(36)	(40)	(98)	(878)
86 Railway Or Tramway Locomotives, Rolling Stock, T	(30)	(35)	(61)	(41)	(38)	(66)	(90)	(92)	(82)	(48)	(50)	(90)	(658)
09 Coffee, Tea, Mate And Spices	(35)	(43)	(35)	(36)	(39)	(46)	(43)	(44)	(46)	(55)	(68)	(85)	(497)
50 Silk, Including Yarns And Woven Fabrics Thereof	(31)	(26)	(23)	(62)	(100)	(91)	(66)	(57)	(37)	(35)	(38)	(56)	(566)
32 Tanning Or Dyeing Extracts; Tannins And Derivat	(12)	(14)	(25)	(28)	(43)	(66)	(56)	(30)	6	(19)	(26)	(56)	(342)
93 Arms And Ammunition; Parts & Accessories Ther	(105)	(59)	(10)	(3)	(0)	(4)	(8)	(10)	(15)	(32)	(38)	(55)	(259)
53 Vegetable Textile Fibers Neso; Yarns & Woven Fa	(24)	(24)	(18)	(19)	(25)	(23)	(26)	(29)	(16)	(21)	(28)	(52)	(140)
60 Knitted Or Crocheted Fabrics	(5)	(2)	1	0	(11)	(6)	(1)	1	5	(3)	(46)	(52)	(408)
13 Lac; Gums; Resins And Other Vegetable Saps	(16)	(12)	(23)	(34)	(49)	(70)	(45)	(39)	(30)	(34)	(34)	(50)	(408)
30 Pharmaceutical Products	(20)	(26)	(10)	(21)	(62)	(86)	(118)	(136)	(27)	(8)	(26)	(45)	(538)
19 Preparations Of Cereals, Flour, Starch Or Milk; Ba	(11)	(14)	(18)	(18)	(16)	(21)	(23)	(19)	(22)	(28)	(34)	(39)	(238)
79 Zinc And Articles Thereof	(10)	(14)	(16)	(21)	(38)	(90)	(101)	(65)	(73)	(74)	(50)	(31)	(558)
59 Impregnated, Coated, Covered Or Laminated Text	2	1	2	2	5	1	9	6	6	2	2	30	5
17 Sugars And Sugar Confectionary	(4)	(4)	(4)	(5)	(8)	(8)	(8)	(8)	(4)	(34)	(29)	(29)	(136)
08 Edible Fruit And Nuts; Peel Of Citrus Fruit Or Mel	(16)	(11)	(10)	(20)	(20)	(13)	(31)	6	7	(4)	(12)	(28)	(126)
37 Photographic Or Cinematographic Goods	9	4	(1)	0	(2)	9	27	38	36	72	95	28	238
89 Ships, Boats And Floating Structures	(5)	(5)	(14)	(8)	(9)	(12)	(18)	(21)	(24)	(6)	(6)	(21)	(139)
54 Manmade Filaments, Including Yarns & Woven Fal	(4)	0	5	(6)	(6)	(7)	(7)	(7)	3	11	9	(19)	(13)
22 Beverages, Spirits And Vinegar	(8)	(5)	(6)	(6)	(7)	(6)	(7)	(13)	(18)	(22)	(18)	(19)	(122)
18 Cocoa And Cocoa Preparations	(28)	(20)	(33)	(33)	(42)	(29)	(15)	(10)	(5)	(1)	0	(14)	(170)
06 Live Trees And Other Plants; Bulbs, Roots And Th	(3)	(3)	(3)	(6)	(6)	(3)	(4)	(6)	(9)	(11)	(14)	(13)	(72)
01 Live Animals	7	8	8	6	6	4	4	4	3	2	9	9	35
11 Milling Industry Products; Malt; Starches; Inulin	(1)	(4)	(2)	(3)	(3)	(1)	(1)	(1)	2	(0)	(5)	(8)	(23)
45 Cork And Articles Of Cork	(0)	0	0	0	(0)	2	(0)	(1)	(1)	(2)	(5)	(8)	(15)
78 Lead And Articles Thereof	0	(0)	(0)	(0)	(0)	(7)	(23)	(33)	(16)	2	12	(0)	(66)
51 Wool And Fine Or Coarse Animal Hair, Including Y	(6)	(5)	(2)	(1)	(13)	(11)	(8)	(5)	(3)	(2)	4	(0)	(36)
14 Vegetable Plaiting Materials And Vegetable Produ	(6)	(5)	(0)	(4)	(1)	0	0	4	(4)	(6)	(6)	(0)	(90)
04 Dairy Produce; Birds' Eggs; Natural Honey; Edible	(28)	(22)	(13)	(28)	(17)	(11)	(15)	(14)	4	11	(10)	3	(17)
24 Tobacco And Manufactured Tobacco Substitutes	(17)	(1)	3	(7)	(4)	(4)	(3)	(18)	(24)	(33)	(12)	7	(95)
23 Residues And Waste From The Food Industries; Pr	2	2	10	131	103	187	26	50	42	51	47	23	671

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HS Industry Codes: \$Millions	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Totals 1995-04
15 Animal Or Vegetable Fats And Oils And Their Clec	\$0	\$132	\$393	\$106	\$160	\$310	\$68	\$13	\$8	\$22	\$94	\$24	\$1,199
35 Aluminoid Substances; Modified Starches; Glue	2	4	(1)	3	9	8	5	18	35	25	36	32	170
72 Iron And Steel.....	65	2	(97)	(141)	(140)	(161)	(85)	(122)	261	251	882	45	734
75 Nickel And Articles Thereof.....	3	(1)	3	3	7	6	5	11	17	22	26	46	147
52 Meat And Edible Meat Offal.....	18	27	35	64	82	53	58	90	66	74	134	57	663
55 Manmade Staple Fibers, Including Yarns & Woven:	49	74	153	108	37	13	24	29	96	47	47	103	617
28 Ores, Slag And Ash.....	(11)	(20)	8	82	(10)	(13)	1	9	(31)	(16)	34	105	182
29 Organic Chemicals.....	(13)	(45)	(97)	(182)	(244)	(303)	(305)	(193)	(317)	(157)	34	116	(1,230)
38 Miscellaneous Edible Preparations.....	(12)	(45)	(7)	43	(5)	(17)	95	607	338	672	98	98	1,083
31 Miscellaneous Chemical Products.....	31	92	70	42	69	68	93	125	133	135	96	269	1,083
28 Fertilizers.....	293	944	1,204	890	1,049	1,083	935	607	398	672	402	287	7,483
74 Copper And Articles Thereof.....	34	29	81	441	43	(10)	(32)	140	140	154	435	345	1,289
10 Cereals.....	274	168	1,144	441	43	90	40	28	21	28	13	476	2,324
41 Raw Hides And Skins (Other Than Furkins).....	21	54	105	116	134	157	126	270	438	427	477	528	2,768
47 Pulp Of Wood Or Other Fibrous Cellulosic Material	46	105	184	197	148	156	193	274	329	414	605	763	3,292
52 Cotton Including Yarns And Woven Fabrics Thereof	(189)	498	691	615	419	4	(174)	(152)	(101)	(93)	586	1,281	3,140
88 Aircraft, Spacecraft, And Parts Thereof.....	2,172	1,885	1,152	1,681	2,086	3,545	2,290	1,668	2,389	3,374	2,368	1,870	22,413
12 Oil Seeds And Oleaginous Fruits (Soy Beans).....	(16)	(35)	6	387	355	225	288	988	984	956	2,846	2,260	9,234

US Dept. of Commerce, Bureau of the Census and MBG Information Services

Panel III: Discussion, Questions and Answers

Cochair BARTHOLOMEW. Thank you, Dr. McMillion. Thank you to all of our panelists. We'll move into questioning. Commissioner Dreyer.

Cochair TEUFEL DREYER. Several people have mentioned that they think the problem with Taiwan can be managed, and most particularly Dr. Goldstein, and I am wondering how you think this might best be done? We haven't done a terrific job of managing it so far, even though perhaps this is a perception similar to the optimists glass half empty, and the pessimist's a glass half full. There has been no war so the glass is half full, but there has been a continuation of tension, so the glass is half empty. What do we do?

Dr. GOLDSTEIN. Well, I think I would take issue with the question about how well we've done. I actually think whatever disagreements I might have with the current Administration on other policies; I think they've done an outstanding job both in terms of their general policy towards China but especially in handling the issue of cross-Strait relations.

I think they are largely responsible for helping us head off what could have been an extremely dangerous crisis in late 2003, early 2004. I'm sure you're familiar with the situation at the Strait in that time.

What can we do? I would say we should do more of the same and try to keep the glass as close to—I think it's more than half full. I think it's maybe 85 percent full because of the Administration's policies and because, in fact, there are political forces on both sides of the Strait who realize the disaster that a militarization of the relationship would entail, and that staying the current course is really not all that bad, that there are incentives on both sides of the Strait now, and I think efforts ongoing on both sides of the Strait to search for a political resolution of their differences, even while both sides are doing things militarily to try to make sure that nobody takes advantage of the current situation.

Cochair TEUFEL DREYER. So you would not be quite as pessimistic as the several people who came before you who say that the Taiwan Strait is the most dangerous flashpoint we've got?

Dr. GOLDSTEIN. It depends what you mean by most dangerous. If you mean the one where there is the highest probability of a conflict, I would say I don't think it's the most dangerous place in the world or in maybe U.S.-China relations, but if you're talking about the consequences of a conflict, I definitely think it is an extremely dangerous place for the United States and U.S.-Chinese relations, not least of which because there is the risk that any conflict that begins there will escalate in ways we can't predict as we were all reminded a couple of weeks ago.

Cochair TEUFEL DREYER. Mr. Schriver?

Mr. SCHRIVER. Well, I appreciate the comments about the Administration's handling of cross-Strait issues, I think the problem is actually getting a little harder in some ways, and I think the most significant way is the shift in the military balance. The PLA build up opposite Taiwan has been quite extraordinary and this is well-documented in the DoD report that was just released, particularly in the area of ballistic and cruise missiles and remarkably given this buildup, we've seen a decrease in Taiwan's investment

in its own defenses, depending on how you run the numbers, essentially over a decade of declining defense expenditures in Taiwan.

I think this makes dialogue more difficult and real genuine political dialogue much more difficult. There are other factors as well. I think the regime in Beijing, prior to the transition to Hu Jintao, Wen Jiabao, some people sort of forecasted that this would be a more moderate and more pragmatic and more sophisticated group. I think that remains to be seen.

But in the short term, I think there's a neuralgia surrounding Taiwan that has forced this group to be a little more hard-line. I think it's sort of natural in domestic politics. Hu and Wen need to prove their bona fides with the PLA and the other hardliners. But things like the anti-secession law and some other things lead me to believe that we haven't seen that more moderate and pragmatic side yet.

I think the politics on Taiwan as much as we want to celebrate and endorse what has been a remarkable accomplishment there in terms of transitioning to a democracy in an incredibly short period of time, really a decade, a complete success, this has also brought some politics that are difficult for outside parties to manage, if not impossible, and this is seen as increasingly provocative in Beijing.

Again, we can celebrate what's happening on Taiwan, but we can't wish away how Beijing is receiving this. So I think the problem is getting a little more difficult. I didn't get into saying what I think we should do about it, but I fear I'm running on a little too long.

Cochair TEUFEL DREYER. Dr. Tsang?

Dr. TSANG. I would say three words are key here. One is deterrence. The other is engagement and the third is clarification. While I have emphasized that the Chinese would be prepared to do whatever it takes to take Taiwan if it comes down to it, I also hope that I made it quite clear that I think the Chinese want to do it on the cheap, if they could.

And this is in a sense where the point that Mr. Schriver made about the increasing capabilities on the part of the Chinese are terribly important. If they think they have the capabilities to take Taiwan, the temptation increases dramatically.

If they calculate that the cost for taking Taiwan is lower than it actually may turn out to be, the temptation will be so much the greater, and therefore the important thing is how to remove the temptations. You don't have a uniform view about Taiwan within China in terms of how to take Taiwan back. You have a uniform view in terms of 'we want Taiwan back,' but not how to do it. In that internal debate, it becomes very important for the Chinese to understand where the United States really stands, that if they go on to try to get Taiwan, and if the matter, in fact, escalates, then the U.S. involvement will be sufficient or to the extent that it simply will not be worth their while, then they will think a lot harder.

The second point about miscalculation is the intentions of the Taiwanese administration. The Chinese can react more robustly towards Taiwan by misunderstanding what is happening in Taiwan. If they think the administration in Taiwan were, if you like, deliberately crossing China's bottom line, they're more likely to act.

But as a democracy in Taiwan, with a very rough and tumble politics in Taiwan, rhetoric sometimes is made without necessarily committing the hands of the administration in Taipei. The Chinese have difficulties understanding that, so I think what would be most useful is a combination of all these elements—deterrence in terms of capability, engagement in terms of talking to the Chinese and make them feel not so worried about the developments in Taiwan, and clarification so that there would be less chance of miscalculation. I hope that will help.

Cochair TEUFEL DREYER. Thank you. Dr. McMillion, do you have something to add to that?

Dr. MCMILLION. I might just add that beyond the buildup along the Strait, China, of course, engages in international activity on many levels and with respect to Taiwan, China has been remarkably effective in drawing Taiwan's commercial interests into the mainland to the point where Taiwan is now increasingly dependent on the mainland even for its technology sector. This gives China increased leverage over Taiwan. I think in addition to, of course, the military concerns which we've identified, the Commission needs to pay very careful attention to Taiwan's dependence, growing dependence on the mainland for commercial activity.

Cochair TEUFEL DREYER. Thank you all very much.

Cochair BARTHOLOMEW. Thank you. Commissioner Wessel.

Cochair WESSEL. Thank you all for being here. Mr. Schriver, for a moment, I'd like to pick up on your first comment about using a sports analogy only in that I think we're probably playing by summer rules as it relates to the game of golf. The Chinese are playing by winter rules or some set of rules that I don't know that we've fully defined.

I'd like to understand from the panelists their view of our analysis of China. We had a problem in the 1980s with Japan. We always wanted them to be more like us. We assumed that the prism through which everyone views the world is the U.S. prism of our values, our ideals, our approach to life, economy, et cetera.

You were inside the system. How do you think we need to be looking at China in terms of what are its goals in the world? Is it expansionist? Is it preservationist if you will? Dr. Tsang talked about—I believe it was you who said 20 to 30 years, I think you said is the sort of window for the sustainability of the current regime.

Are we looking at this the right way? This is for all the panelists. What are their objectives and how should we view those as they drive their outward policies? Mr. Schriver?

Mr. SCHRIVER. Well, again, I think the immediate focus is on building their power, both at home, their comprehensive national power, and improving their position in the world vis-à-vis other powers and I think primarily vis-à-vis the United States.

Cochair WESSEL. A zero sum sense then?

Mr. SCHRIVER. It almost has to be in order in the international system for China to be more influential. Given where we sit now, there has to be some, in the Chinese vision, some diminishment of U.S. power and influence, and I think given what we see from the regime in terms of where they place value, and it's clearly not in things that we place value on—human rights and religious freedom

and the way minorities and minority ethnic groups are treated. I think we should be concerned about China as it increases its influence and how it may behave internationally.

We've seen some things the way they've pursued their interests in regimes. I think Mr. Donnelly during a previous panel mentioned Sudan and Venezuela. I would add Iran. I think the way Mr. Karimov was treated a week after the crackdown; the fact that he was given a full state visit with all the bells and whistles suggests that this is a country that doesn't share our values, and we need to think seriously about it, and I think that is the major difference between Japan's rise a decade and a half earlier, and what we see from China now, even though there were reasons to be uncomfortable with the potential economic competition that Japan was posing, it was nonetheless a like-minded country in so many ways and a democracy and a treaty ally.

So I think China should be viewed a little differently, not that we're on a collision course for an adversarial relationship, but it's something that I think needs to be taken into account.

Cochair WESSEL. Other panelists?

Dr. GOLDSTEIN. Well, I don't really take much issue with what Randy Schriver said except even if we could somehow tap into the Chinese leadership's mind and know exactly what their goals are, that's almost irrelevant because what their goals today may be doesn't tell us what their goals will be once they're much more powerful in the future, a point I was trying to emphasize.

The other thing is I believe China's behavior is probably of greater interest to us than their goals. Goals express a lot about intentions, but I think behavior tells us about what they're doing that might affect American interests around the world and American values.

And third, I think part of what China does, whatever their goals may be now, will be shaped by what the United States does. This is a strategic relationship, which implies that both parties adjust their behavior in response to what the other is doing.

Dr. TSANG. In terms of China's objectives, I would say perhaps two words. One is rich; the other is powerful. That's basically what the Communist movement in China has been from its foundations to want to achieve for China and that remains I think the objective that they want.

But in terms of whether your policies should be making China more like us, I don't think it's necessarily a matter of making the Chinese more like Americans. I think it's more a matter of perhaps encouraging the Chinese to reform and change in their own way. I personally do not see a serious objection to the Communist Party of China remaining in power if that Party is changed so much that it will actually respect human rights, and it will respect rule of law and the democratic principles in China.

In that case, if they continue to want to call themselves the Communist Party of China, what's the problem? But the important thing is to enable them and to encourage them to change, and you have internal dynamics within the Chinese leadership. It's not of one voice. And perhaps by engaging them in a way that will help those who want to change, and it becomes easier if it's not a matter

of simply importing a Western, in this case American, model to China.

Cochair WESSEL. Human rights, rule of law, those issues are Western ideals and hopes. You seem to indicate that our goal is to have them adopt our vision.

Dr. TSANG. I respectfully disagree, sir. Those principles were enshrined in the U.N. Charter. The Chinese government was a party to the drafting of the U.N. Charter. The Chinese government today claims itself to be a successor state of the Chinese government that signed on to the U.N. Charter and the U.N. Declaration of Human Rights.

If they are the successor state to that Chinese government, then they have to take on the fact that those were values that China subscribes to more than half a century ago. It's not just American, sir.

Cochair WESSEL. If time allows for Dr. McMillion to respond.

Cochair BARTHOLOMEW. Quickly.

Dr. MCMILLION. Commissioner, I'm concerned with the pace of the growing friction between China and the U.S. and frankly Japan and Europe as well. I think a very important comment was known but made in the earlier panel, that China really needs seven, eight percent growth in order to accommodate these million jobs per month that it needs to create to continue to satisfy the wants of still a very poor, particularly in the countryside, very poor, very large country.

And it's becoming more and more difficult to achieve seven and eight percent growth. I know they got 9.5 and they're trying to cool it down, but it's more and more difficult to achieve that seven, eight, nine percent growth without taking from others, whether it's Japan or the United States, or Europe, and the friction there I think is growing, and as I indicated earlier, we in the United States have been able to accommodate that with massive borrowing for quite some time.

But this is not something that I think can be sustained, certainly not for ten or 20 years, and my concern is that the nature of the problem is worsening rapidly.

Cochair BARTHOLOMEW. Thank you. Dr. Tsang, I think it's interesting you used the words "rich" and "powerful" in terms of what the goals perhaps of the Chinese Communist Party are. The question in my mind is that whether that's goals for the Chinese people to be rich and powerful or whether those are goals for the members of the Communist Party to be rich and powerful, and what that means as society moves forward.

Commissioner Becker.

Commissioner BECKER. Thank you, Madam Chairman. I want to thank the panel for a very interesting presentation. I have two questions. Dr. McMillion, you've got the second one.

I listen to this phrase about the United States wanting to frustrate China's rise to be a great power, and I just want to make an offhand comment. In the year 2000, we embraced China with PNTR. We were the prime movers of a great wealth and technology that's enabled China to start down this road. But my question to you four is about the stability of China.

Fifty years is not too long. Fifty years ago, we had the Korean War and the Korean Peninsula and three divisions of Chinese came across the Yalu River and engaged the Americans in battle. Today, they talk in China about meeting the Americans in war, and that there is nothing to fear from the Americans, that they can be beaten, and they don't have to be as powerful as America if they do it strategically and regionally.

So this brings me back to several instances that I thought were flashpoints in China: Tiananmen Square; the EP3; even as recently as Japan, the riots—these are engineered. It doesn't seem any one of those incidents could have led to war, and it doesn't seem to me that we have a stable government in China, a reliable stable government as we go down the road.

Tibet. We have overtures from China now about—their history would indicate that they have a claim on Korea, they have a claim on Thailand, and who knows how all of this is going to manifest itself. I picture China as a big boy squeezing into a crowded room and just elbowing and finding a place to go in there.

Dr. Tsang, you said China wants Taiwan back. We've had witnesses testify here that they never had in the first place, let alone to say that they demand it back.

The last point I'd like to make on the stability part, the United States has been threatened several times by PLA authorities to nuke us. They can take out Los Angeles and just recently now we had the general speak very forcefully about a nuclear response if there is some kind of altercation or engagement with Taiwan.

We all know that China is reinforcing itself militarily in and around Taiwan in order to be able to marginalize the Seventh Fleet. Where does this leave us? Where do you think this leaves us as far as dealing with a stable government and one that can go through the transition stages to possibly a democracy or at least a respected place in the world scene?

Dr. TSANG. Well, to answer your last question, first, Commissioner, I don't think we know where China will be in 20, 30 years time. I don't think the Chinese leaders know where China will be in 20, 30 years time. They may like to say that things will simply be better. They always say that since the Communists came to power; things will always be better. When you even have a period of three or four years, you have 30, 40 million people starve to death, tomorrow will still be better.

But realistically, that kind of projection of where China will be we really do not know. I don't think they really can know. The stability of the Chinese situation I think needs to be addressed in terms of the nature of the stability in China since the collapse of Communism in the world generally, and collapse of Communism as a stated ideology in China around 1990.

I think the description I would have for the Chinese capacity for political, social situation is very brittle. The government is on the one hand very hard and very strong, and appears to be very able to deal with dissent and differences, but on the other hand, it's fundamentally potentially very fragile.

If it has been hit very hard, it can break up very, very quickly, but one look at the situation in China and the situation after Tiananmen Square, the reason why the Chinese Communist sys-

tem could survive the collapse of Communism in Eastern Europe and the Soviet Union was in a sense ironically because Tiananmen Square massacre happened. It proved, it demonstrated to people in China that the Communist Party had both the means and the will to do whatever it takes to stay in power, and therefore people were reluctant to come out and demonstrate even when Communism was collapsing elsewhere.

If you have a situation where the Chinese can no longer, the Chinese government because of perhaps internal disagreements of the top leadership, cannot convince its people that it will be able to react and respond swiftly and effectively, then you have a situation that can very easily and very quickly escalate out of control.

And how do you plan in policy terms for an eventuality like that? I don't think you can. I think you have to plan with the reality of what you have, but be prepared that something like that can be just around the corner and can happen, and when it happens, you will be very quick and you will have to respond very, very quickly to that situation.

The stability in China is problematic. But as long as you still have that seven to eight percent economic growth and a demonstration that the leadership in Beijing is united and able to use whatever it takes to suppress dissent, you will still have that stability, even though you will have more and more riots and disturbances. I think I should stop here. Thank you.

Cochair BARTHOLOMEW. Other panelists briefly.

Mr. SCHRIVER. Well, I think that's an excellent answer. I think there are two kinds of instability, just very briefly, that we should be concerned about. One is does the leadership have full rudder control if you will over decisionmaking on some of these very core sensitive issues like Taiwan, increasingly like Japan, or have they through their own rhetoric, through their own bargain with the people of China, through this nationalism card, have they put themselves into a cul-de-sac where they would be forced to act in ways that really are contrary to China's interests in the event of a spark or a crisis? And I think that's number one.

Number two, it is not inconceivable that this could all unravel for China. There isn't a large movement that is sort of knit together that opposes the regime, but there are ethnic minorities who have a lot of problems with the regime. There is labor unrest. There is environmental problems. I'm an Oregonian. We're all greens in Oregon, but our debates are about spotted owls and things like that. We are talking about entire towns that are ghost towns because you can't drink the water; you can't breathe the air.

There are plenty of sources of instability that could compel people to knit together and oppose the regime, and I think we can't discount that possibility as well.

Commissioner BECKER. I'm not talking about the people challenging the regime. I'm talking about the military leaders, the Communist Party that leads China that is dealing with the rest of the world that is dealing with us. The way they flew off the handle on that EP3 issue, I think was disgraceful. It was only through the stability of the United States to pull itself in, apologize, and do whatever the hell they wanted to be able to sweep that aside.

And the fact of arming, threatening us with nuclear weapons. Now has this happened frequently enough that should we believe them?

Cochair BARTHOLOMEW. Commissioner Becker, we are well beyond the timeframe here. Perhaps we can fold some of the responses into some of the other questions that are being asked.

Chairman D'AMATO. Thank you. Thank you very much, Madam Chairwoman. I have two quick questions. The first, I want to go back to the stability question. I was reading this article in the New York Times a couple days ago about this group of peasants in one area that shut down a pharmaceutical operation there. And I get the impression these peasants are a gritty, tough bunch of cookies. These little 70-year-old women throwing themselves at the barricade. I'm wondering whether we understand what the level of instability is in the Chinese countryside given the lack of reporting that we get.

I think I read—it may be a misprint—maybe 70,000 instances last year. That's 200 a day. I'm wondering whether they're sitting on a powder keg. The problem is these villagers understand, it seems to me, that they're being taken for a ride. They're not benefiting from this development. They have no social safety net. The regime apparently has given up on that. What's in it for them?

We're talking about hundreds of millions of people. The message is getting to them, there's nothing in it for us, except that they're ruining our land and our water and our way of living. Dr. Tsang, my question is do we really have an understanding of the level of instability in China? These numbers are staggering.

Dr. TSANG. I agree these kinds of numbers are staggering, but then if we put in the context of the size of the Chinese peasantry, and the size of the country and the long history of peasant riots in China, 70,000 a year is something that the state can deal with. Historically it has dealt with that. Chinese peasants you quite rightly say are some of the toughest people you can find on earth. They endure some unbelievable hardships.

Chairman D'AMATO. Yes.

Dr. TSANG. And then when they have absolutely nothing to lose, they would do a lot of things, but here I think we're dealing with a situation that we are getting to know more about China because access is becoming more available. So the numbers that we are seeing now are higher than perhaps the number we saw previously, but there were probably, in fact, more that happened say five years ago than our figures of five years ago would show.

The situation is getting more serious. I think that is entirely true. But so far the indications are that the state is still able to deal with that through a combination of crackdowns, paying off, and otherwise demonstrating that this is purely local, and we will tolerate it to an extent that it doesn't actually challenge the central authority. I think the real test is when you have disturbances like that that are being seen as challenging the authority of the central government. That becomes the real issue I think.

The problem for the Chinese government with the Falon Gong was that it actually happened in Beijing right by Zhongnanhai and it was seen as a challenge right to the central leadership, and they reacted in a much more robust way than with the local riots.

Chairman D'AMATO. Yes. I'm wondering whether there is a challenge to the economic development too if factory after factory gets closed down because the villagers understand what's happening to their quality of life? I have no way of evaluating that, but this level, 200 incidents a day, you're talking about the development process, I think, to some extent here. I don't know how you evaluate it.

I have one more quick question, Madam Chairman. And that is on Taiwan, I think the comment was made that there is going to be some kind of perhaps a political resolution of their differences. I don't think there is any political resolution of any differences that can be accomplished here. We have a totalitarian dictatorship attempting to absorb a democracy. That's not a political resolution, and short of that I don't understand what we're talking about with regard to China.

But, Mr. Schriver, you mentioned that you might have some ideas about some additional things that we might be able to do about this cross-Strait problem. It seems to be a growing problem. Maybe you could elaborate a little bit on what your thoughts are there.

Mr. SCHRIVER. Sure. Well, let me just mention a few things. I think we have to be clear in Asia and more broadly that it is in our interests to see Taiwan sustained as a democracy, as a free people. I think Taiwan is increasingly more important, not less important, to our interests in Asia and Taiwan can be part of what changes China for the better eventually.

It is an example that others can learn from including the Chinese, and so I think this needs to be part of a process where we also help Taiwan with what is now an increasing isolation in the region. If Taiwan looks around, frankly, it's the United States, in some ways Japan, and it's almost full stop at that point. So Taiwan is becoming increasingly isolated. We need to do what we can do sort of turn that trend around and I think the primary means of doing that is to express our strong interest in seeing this democracy and this free people sustained.

Number two, I think we have to do something about the military equation. It's very difficult in that we've got an offer on the table that the legislature had not acted upon in Taiwan. You know I served in the Clinton Administration and I used to be accused of endangering Taiwan's national security by preventing the transfer of systems that were critical to their national defense.

Now, I'm accused of shoving systems down their throat that they can't afford and don't need for the benefit of U.S. defense industry and my transformation took place over the course about five years. But this is something that we have to address and if Taiwan doesn't make the right decisions within the legislature, we need to think about how we can do a better job of sustaining the military deterrence unilaterally.

Finally, I think it is important that we try to promote dialogue between the two sides. This is always a sticky issue, a tricky thing. But I think there is some foundation—we've mentioned the commercial links. There's intermarriage. There's a lot of areas where they do have shared interests, transnational crime, a range of things, and I think there's probably a role for outside parties and

probably will fall squarely on our shoulders as the one influential country in the cross-Strait environment that we can do things to bring the two sides together.

Chairman D'AMATO. Thank you very much.

Dr. GOLDSTEIN. If I could just jump in here, one point on Taiwan and one point on your stability concern. I think you're correct; there's instability in rural China. I was in Beijing last month conducting interviews mainly about Chinese grand strategy but also talked to people about this growing problem of instability.

And one interlocutor very wisely, I think, stated the equation to me, which it's the Communist Party view, is who has vested interest in the current system? You're right. There are a lot of people in rural China who are losing out. There are some people in urban China who are losing out. But there are a lot of important groups in urban China, which is what is politically most important, not only the Communist Party and the military that can be deployed in urban China, but also the professional classes and the middle class and that part of the working class that's working in urban China that has a vested interest in avoiding the economic success falling apart. And I think that's what they're banking on.

Second, very briefly on Taiwan, I think I would disagree with your view that we've got, however you want to characterize the regime, whether it's a totalitarian dictatorship or just a dictatorship on the mainland and a democracy on Taiwan, which is a democracy, that they're determined to take it over or integrate it. I think, and I'm going to depart from the view that Randy Schriver expressed earlier, I think that there has been a change in China's Taiwan policy in the transition from Jiang Zemin to Hu Jintao, and I think the change has been reflected in the last six to eight months, which is that China has more or less abandoned talking about reintegrating Taiwan with the mainland and they're more interested in simply drawing a very hard line on independence, and they're willing to defer that question of what the ultimate relationship is going to be to generations that are either not yet alive or too young to formulate policy.

Chairman D'AMATO. Thank you. Let's hope so. Let's hope so. Thank you.

Cochair BARTHOLOMEW. We actually are running out of time. This panel was originally supposed to end at one o'clock. We can stay a little bit longer. It's just lunch. Do our panelists have some flexibility that they can stay longer? I know that people are saying things that people see some interest in responding to. Dr. McMillion, very quickly you wanted to say something, and then we'll move on to the next Commissioners.

Dr. MCMILLION. Also two things to Chairman D'Amato's point. First, on the instability in China, I think that's a very important issue that is really underappreciated in the United States. What if China does begin to fall apart? Many companies have basically bet the company on China. We have some of the world's largest financial institutions buying massive amounts of bad assets, non-performing assets in China. What will the effects be on our companies and on our country if it does fall apart? I think that's an important whole different area that needs some attention.

And just very briefly, on the Taiwan issue. I couldn't agree more that the United States needs to show more commercial support for Taiwan, but what has been happening is exactly the opposite. We're shifting from Taiwan to the mainland.

Cochair BARTHOLOMEW. Vice Chairman Robinson.

Vice Chairman ROBINSON. Thank you. Staying on Taiwan for just a moment. It does seem to be if you call the trend lines that we've talked about today a kind of gathering storm. What I'm hearing is basically that you have a greater Taiwan economic dependence on the mainland, which we've seen in quite dramatic terms. We have an increasingly striking military imbalance, a surprising indifference on the part of Taiwan to its defense-related shortfalls. We've got rising nationalism and in a sense what I would think of as emotionalism on the part of China, particularly in relation to Taiwan.

You've got greater identification of the Taiwan people as an independent sovereign nation. All of those trends we would agree with and getting to Dr. Tsang's point, this is a temptation in multiple forms that may be too great to bear. I hope that Dr. Goldstein is right, that they've taken this longer view. But there are some pacing items out there, and I wanted to get your reaction to one.

Aegis-based missile defense on our naval platforms, our Aegis-based destroyers and cruisers, the fact that we have at least the potential in the future to have an interoperable capability with Japan. We're jointly developing the SM3 upper tier missile for that Aegis platform. It's not anywhere on the horizon immediately, but say 2010, even 2012, you could have the beginning of China's missile threat to be put at some risk. It gets back to that old adage that we used to say in the nuclear days, use it or lose it. The Chinese could calculate that all of a sudden, this overwhelming force and advantage is starting to be redressed in a dramatic way and Japan, as you know, in its relationship with China is going south a lot faster than U.S.-China relations and for more reasons, not to mention the East China Sea and the historical context. I don't even need to review China-Japan relations at this stage—just to say that it's problematic and everybody I talk to tells me that it's likely to get worse.

So it just means that Japan is going to be more engaged and it's going to be more on our side. I would just like your reaction to the fact that some of these trend lines are going to be, in effect, interdicted by new developments, action-forcing events, as we used to call them.

Mr. SCHRIVER. Okay. One point on Japan and one point on Taiwan. I think we need to have an alliance with Japan that is appropriate for 21st century challenges, and I think we don't do ourselves any favors if we don't acknowledge that the uncertainties related to the future of China—we don't have to cast it as an outright threat—but the uncertainties related to China's development is an alliance issue. It should drive alliance decisions. It should drive questions of force posture and how we plan with our friends in Japan.

This is a very uncomfortable topic for our Japanese friends and others to say this. No one wants to be entrapped in an alliance to contain China. That's not what I'm talking about. That's not what I think we should be engaged in. I think we should have an alli-

ance that's appropriate for the challenges we're facing today and the uncertainties related to China are at the top of that list.

On Taiwan, I think it's remarkable, 650 plus missiles, and remarkable what has not been done on the Taiwan side. Before Aegis, there was an offer on the table for Patriot missiles and enhanced capabilities there, and I think Taiwan should move on that immediately.

There's a lot Taiwan could do. Department of Defense talks about the hardening of Taiwan, hardening command and control nodes, rapid runway repair, a range of things that are actually very low cost, very low tech, that could strengthen Taiwan's ability to absorb strikes, still be a country that's functioning, up and running, and be militarily able to defend themselves, even with this incredible missile threat.

But we're seeing inaction at this point, and it just, it really mystifies me, but I think something needs to be done to turn that around.

Cochair BARTHOLOMEW. Any of our other witnesses briefly?

Dr. TSANG. Briefly, two things. One is that I don't think it's necessary to come to any agreement with the Chinese over Taiwan. You will not come to any agreement. Neither you nor Taiwan will come to any agreement with the Chinese over Taiwan. All you need to do, I think, is to watch the issue and make sure that tension doesn't arise in the next 20, 30 years, and let things change in China. And then you have a new ball game and one doesn't know what that ball game will be.

But in terms of how to deal with that Chinese missile threat and all that, I would be more inclined to think that—and this is very much in line with what Mr. Schriver has already said—a lot of other things to do rather than the big ticket weapon systems to deal with the actual missile threat. The Aegis system is terribly expensive. Likewise, the PAC3. And how many do you actually need? How many would the Taiwanese actually need to deal with the projected increase in Chinese missile capability next five, ten years down the line?

They would be much better off using that money to increase a whole range of other lower tech and much lower cost reforms that would increase the interoperability and ensure that they will have the capability to defend themselves for long enough for the U.S. political process to run its course for solution to come out. There is no way a country of Taiwan's size can have sufficient military capability to defend itself sufficiently on a sustainable basis against a threat posed from a country like China.

Dr. GOLDSTEIN. Very, very briefly. Let me just toss in an optimist—I guess I'm being too optimistic today. You worry about the Chinese, it's been said, being tempted to do something if the balance tilts too far in its favor. I think they are a long way from having a balance that makes them tempted to use force. I would worry more about them panicking into using force, and I think you were getting at that with the "use them or lose them" deal.

I also think we're a long way from them choosing to use force in a panic mode because they understand exactly what's the end game if that happens.

Cochair BARTHOLOMEW. Thank you, Dr. Goldstein. Just a reminder to my colleagues up here. We're each given an allotted period of time for questioning and the longer that we speak in that questioning period, the less opportunity our witnesses have to respond.

Commissioner Mulloy.

Commissioner MULLOY. Thank you, Madam Chairman. Thank you to this panel. This is directed to Dr. Tsang and Dr. Goldstein. I'm a trade and investment guy, not a big geopolitical thinker or historian and that's why I want to get this out to you.

I remember sitting on the beach one year reading *The Rise and Fall of the Great Powers* by Paul Kennedy. One line in that book is that there are enormous implications for your political and military development and your position in the world with just minor changes in terms of how fast you're growing economically.

Somebody is growing at two percent. Somebody is growing at four percent. Over a 20-year period, your positions change dramatically. We're growing at three percent the last number of years. China has been growing ten and 11 percent. Now, you all say we're not sure where we're all headed in this relationship with China.

We can't control what's going to happen in China, but we can control what we're doing. Dr. McMillion showed us how dramatically China has policies in place to help bring trade, investment, technology, other things to build their economy, and we're not sure what they're going to do with that stronger economy.

We know that our corporations are playing a role in all this and they're enticed to play that role. And that our own government doesn't seem to have any policy or incentives or vision of what we want them to be doing. Do you think our elected leaders rather than our corporate leaders should be playing a bigger role in how we're engaging with China in the terms of investment, tech transfer, moving this, and we have then not only moving it there, we have built channels to bring all the goods that are made right back here and running a \$200 billion trade deficit this year, maybe \$250 billion next year? I'm not out to demonize China. I'm saying what are we doing and do we need to take different strategies and visions of where this is headed just looking at it as a historian and understanding the larger trends? Dr. Tsang, and then go to Dr. Goldstein.

Dr. TSANG. Well, thank you. To address your last point first, Commissioner, I believe in free trade myself. I don't believe government should tell business people what to export, what not to export and where to export or where not to invest.

I think government should leave that to the business people. But that's not in contrast to tight regulations on technology transfer. And I see that as a different matter that does have national security dimensions to it. Governments can and should regulate that sort of thing, and you can have the two things combined together.

Government can also in a sense lay out the picture in terms of the investment prospect in China more clearly to the business people. One of the things about investments in China is an irony which is that you have far more companies that will be prepared to go into China and not make profits for ten years and assume that that is just part of the start-up cost.

But they will not do it anywhere else. Now, that is something that perhaps government studies can explain in terms of previous experiences, how those sorts of things happen and business people can then make up their mind as what to invest or not to invest.

As to whether the growth trajectory will simply change the capabilities of a power and in terms of the power balance of different countries in the world, I think things have changed quite a lot. Technological changes have put us in a somewhat different situation. For the Chinese to catch up with the Americans in terms of the military technologies is going to take a much, much longer gap in terms of much faster growth in China and slower growth in the United States.

You also need to build up the software. You need to have the people, the right mentality, to stop that kind of capabilities. And this perhaps is why the Chinese in the military terms are talking much more about special weapon systems, special things that they can use, that will address that—

Commissioner MULLOY. Since I need to get Dr. Goldstein in the next minute, go ahead, please, Doctor.

Dr. GOLDSTEIN. Okay. The Paul Kennedy reference, the trend lines, things like that, of growth rates, of course, the thing to keep in mind with respect to China and India, are these questions of, are you talking about overall GDP or per capita because you do have to worry about the domestic purposes to which your economic resources are put.

I would also say that in addition to the Defense Department's report on China that just came out, there is an outstanding report by the Rand Corporation on modernizing China's military that, in fact, also addresses the Chinese economy and the connections between the two and examines some of these trend lines, and says, all right, we can't be sure exactly what the trajectory will be, but what will be the conditions that will determine which path of growth China follows and which is more or less plausible.

The second point about free trade and strategic trade, however you want to view it, how should we deal with China if they're acquiring things? I think that's a legitimate question. I think on Unocal and other of these topics, the real question is to sort out the economic from the strategic technology transfer questions, and more broadly to ask questions not just about how much technology is transferred from the United States, but to pay attention to things we can't control but will be important such as China's growing investment domestically in science and technology education, an area where the United States is falling behind.

I don't think they're going to steal the next generation things or at least not going to steal all of them from us, but I think they may develop them on their own. I think this is something to pay closer attention to.

Cochair BARTHOLOMEW. Thank you. Commissioner Bryen.

Commissioner BRYEN. Thank you. I want to address the comment and get a response from Mr. Schriver, if I can, on Taiwan.

I was in Taiwan in 1996 during the Chinese military and missile exercises, and I recall it took some time, first, before the U.S. decided to do something in terms of moving two aircraft carrier task forces, and then the actual movement. It seems to me it was close

to a couple of weeks before they actually were in place. Many years before that, in 1973 October, I was working in the Senate as a staffer during the October war in the Middle East, and it took us 11 days to begin to resupply Israel with equipment that it was running out of or at least thought it was running out of it in the conflict.

In other words, what I'm saying is that there is a fairly substantial gap between desire and performance in these matters. And if Taiwan is not able to defend itself in that period, they're losers. They're in terrible trouble and therefore it becomes really incomprehensible to me, and I suppose to you as well, what is going on there and why, given an unprecedented opportunity to buy equipment from the United States, which wasn't there in anything like that previously, that they seem to have spurned the chance to defend their own people.

I'd like to get your comments on that.

Mr. SCHRIVER. I couldn't agree with you more. We looked at this problem about potential decrease in reaction time, given Chinese build up, and it is a problem, and it's one that falls on the shoulders of our commander of Pacific Forces. His job is getting harder to try to plan to respond to these contingencies.

I can only speculate on what's driving these decisions in Taiwan. And I think it's probably a case where certain people oppose the defense package for some reasons and some people oppose it for others and the net effect is you don't have full support to pass a budget.

There are some that see this only as domestic politics. They either want to use it against the Chen government or they want to use it for leverage for other things. There are some who have a mind-set that China will never attack. It's an interesting thing when you travel there and you talk to them, well, we're both Chinese, they'll never attack. There is rhetoric and it's, you know, it's pretty amazing after you were in Taiwan in 1996, I was in the Pentagon, that we did have a very serious situation, yet some still feel why make the investment; there is no real threat there. This is an imagined threat by Americans and others.

Some believe that—

Commissioner BRYEN. It wasn't very imaginary in Taiwan at the time. It was a very frightening moment.

Mr. SCHRIVER. Right. I understand. Some believe that leaving gaps and vulnerabilities make it more likely that the United States will show up rather than less likely.

So again I think different people oppose the package for different reasons, and the net effect is they just haven't gotten the support they need in the legislative end.

Commissioner BRYEN. I really appreciate your comments and I hope that the message goes forth, and I hope that we can report to our colleagues on Capitol Hill that this is of great urgency. Thank you.

Cochair BARTHOLOMEW. Commissioner Bryen, anything else? You actually have time left.

Commissioner BRYEN. You asked us to be efficient.

Cochair BARTHOLOMEW. We'll credit that for the next round. Commissioner Donnelly.

Commissioner DONNELLY. Apropos of the last discussion on Taiwan, the primary block blocking arm sale are our old buddies, the KMT, and the other members of the Pan Blue Alliance who are routinely trooping over to the mainland advertising themselves as interlocutors without much response from the Bush Administration.

The Bush Administration nominally, friends of mine, at least, have gotten kind of a pass on this. My view would be that our Taiwan policy has been somewhat schizophrenic and our inability to rally to the defense of President Chen to actually get this arms sale package passed has been, while obviously a failing of the Taiwanese government itself, also a failing of the American government, undercutting President Chen at a time when he's our best hope to actually accomplish this goal, which is not only in Taiwan's interest but in our interest, has been if not a moral failing, then certainly a strategic failing, in my regard.

I did want to ask an actual question about the longer-term picture, and I'm also a little confused and disturbed about people's inability to see what the future might bring or to assess Chinese intent. People don't build ballistic and cruise missiles for no reason. They don't buy attack aircraft for no reason. And they don't undertake a broad scale military modernization program, shaped in a certain way, and funded to a pretty good level for no reason.

So, while China doesn't publish a national security strategy equivalent to ours, as you said, it does have a track record of behavior and actions from which it's reasonable to infer an intent, and to say that we can't know what the future might bring is certainly true. We can never perfectly predict the future and there are certainly lots of discontinuities out there in terms of what might happen with China.

I think we can say quite fairly that a straight-line projection of current trends has a pretty disruptive effect on not only East Asian politics but international politics and America's role in the world. If China were to become a great power that did not disrupt the international order, that would be the first such example of that that I can think of in history.

Japan's economic rise of the 1970s, '80s and into the '90s was not a rise of a great power. It was a rise of an economic great power. Japan's previous rise in the early, late 19th and early 20th century, was a traditional great power rise and it occasioned a pretty big war.

So my question is, allowing for the uncertainty of predicting the future, why is it so difficult to see where the trend lines, as we know them now, are leading in ten to 20 years? To me it seems pretty straightforward and pretty obvious, and it also seems to me that the more complexity you get in these discussions, the less clarity you get in these discussions.

So I'd be willing to be argued out of this, but what is the measure of China's rise as a great power as the Chinese see it?

Dr. GOLDSTEIN. Any one of us can jump in?

Commissioner DONNELLY. Anybody.

Dr. GOLDSTEIN. Okay. I'll bite.

Commissioner DONNELLY. It was a statement more than question, I allow.

Dr. GOLDSTEIN. I'll bet dollars to donuts I'm not going to change your mind, although I'm not so sure I want to talk about donuts because I'm getting kind of hungry. In terms of observing the capabilities they're deploying and certainly it's a more modern and larger force day-by-day, the problem in inferring intentions is to say, well, what if their intentions were simply to protect their own national interests and to discourage Taiwan from lurching towards independence, would they be doing something different?

And I don't think so. That's why it's so difficult to tell. This is the beginning of a trend. They're nowhere near, in fact, acquiring the kinds of capabilities that the U.S. and its allies can employ in Asia, let alone elsewhere in the world, and it's just too hard to tell at this point, and as I think several of us have suggested, it almost doesn't matter what they intend to do with it now.

What's going to matter is what they do with it over the course of the next couple of decades as they begin to acquire more and better forces.

The second historical—yes?

Commissioner DONNELLY. A followup question then. Do you see China's national interests as being fundamentally threatened by the current order in East Asia?

Dr. GOLDSTEIN. I think they see it that way. I think they see themselves at a substantial disadvantage, at the mercy of powers around them that have greater force at their disposal, and I think any Chinese government, whether they were the current Communist dictatorship or another government, would probably respond in the same way, trying to strengthen their military capabilities.

Your second point about "has there ever been a power that has risen to become a great power that was not a disruptive influence," I'd say just look at ourselves. The United States is the shining example of a country that rose as a great power and was not a disruptive force on the world scene.

Commissioner DONNELLY. Arguably the Germans, Japanese and the Russians might disagree with that.

Cochair BARTHOLOMEW. Let's let other panelists answer.

Dr. TSANG. Can I comment here? One thing I wanted to say about this weapon systems purchase in Taiwan is that while the KMT has been blocking it in the last couple of years, the problem also came up because the Clinton Administration mishandled it from the very beginning. If they had agreed and came up with a special budget, as it happened, when the F16 sales were offered back in 1992, it probably would have sailed through the legislature in Taiwan without too much problem.

The government dithered and then raised a whole range of other issues that were not really germane to the acquisition of all this capabilities to begin with. That then allowed the whole situation to lose, to get out of hand, and I think that perhaps needs to be taken into account in terms of underlying how much the administration currently in Taiwan does underestimate the threat from China and overestimates the willingness of the United States to come in to bail Taiwan out of the situation.

That's something I think you do need to address. You do need to get administration in Taiwan to take the threat much more seriously and do its own bit.

I think in terms of the Chinese acquisition of their military capabilities, I would, on the one hand, agree with you that you do not acquire that kind of capabilities and never intend to use them. Where I would disagree is how they would actually want to use them. I think the Chinese would much prefer, in fact, to have those capabilities and can make a credible threat which will then force the government in Taipei to negotiate with them rather than actually have to go in and use all those capabilities. Because those capabilities that they have acquired are not without problems.

You have problems if you actually come to a real shooting war whether the Chinese will be able logistically to get the supplies of engines for the SU27s in time for replacing losses and all kinds of many different systems being used in the same armed forces and how you resupply them.

But if they don't actually have to get into actual shooting and yet force the government in Taipei to negotiate, then they would have won, and in addition they will also have acquired the capabilities and resources that Taiwan has to the Chinese capabilities which will catapult China's capabilities in the world league. So I think that is something that perhaps we should also take into account as to how they may be playing the game.

Cochair BARTHOLOMEW. Dr. McMillion, any comments, and then we'll allow Mr. Schriver to close.

Dr. McMILLION. No.

Cochair BARTHOLOMEW. No comments. Okay. Mr. Schriver.

Mr. SCHRIVER. Well, I'm not sure I could change your mind, but I'm not sure I want to. I'm not sure I totally disagree. I think given the uncertainties we've all mentioned, if you ask me whether I'm concerned about the trend lines now, I am.

And I think inattention to this problem, whether it's preoccupation with Iraq and the Middle East or misplaced trust in the future direction of China, I think inattention would be negligent and would be the wrong response. I think the right response in addition to engaging China and on the margins trying to shape that relationship is much more attention in Asia to our alliances, much more attention to Southeast Asia, much more clear support for Taiwan, and I started to address a range of things.

But I think the trend lines are concerning. And I do think this calls for a more proactive response.

Cochair BARTHOLOMEW. With that, we'll close this panel. Thank you very much to the panelists for your generosity. We'll reconvene at 2:10.

[Whereupon, at 1:25 p.m., the hearing recessed, to reconvene at 2:20 p.m., this same day.]

PANEL IV: CHINA'S APPROACH TO AFRICA

Cochair BARTHOLOMEW. Let's reconvene. Thank you very much to our panelists, Ambassador Lyman and Ambassador Shinn. Ambassador Lyman is the former U.S. Ambassador to South Africa and Nigeria as well as a former Assistant Secretary of State for International Organization Affairs. He is currently a Senior Fellow in

Africa Policy Studies at the Council on Foreign Relations where he focuses on Southern and Sub-Saharan Africa. I know him also because of his work at CSIS and the task force focusing on the HIV/AIDS epidemic and its consequences and impact on Africa.

Ambassador David Shinn is the former U.S. Ambassador to Burkina Faso and Ethiopia. He is currently an Adjunct Professor at the George Washington University where he focuses on political developments in East Africa and U.S. policy toward that continent.

We were fortunate this morning that Senator Feingold came and spoke, gave some brief introductory remarks, and mentioned a few countries specifically in Africa. He obviously has a big interest in Africa in looking at what China is up to in Africa, and what it means for the United States. So we look very much forward to your testimony.

Ambassador Lyman, why don't you go ahead and start.

**STATEMENT OF AMBASSADOR PRINCETON N. LYMAN
THE RALPH BUNCHE SENIOR FELLOW IN AFRICA POLICY STUDIES
DIRECTOR OF AFRICA POLICY STUDIES
COUNCIL ON FOREIGN RELATIONS**

Ambassador LYMAN. Thank you very much, and thank you for the invitation to come here and for your interest. I think this is a very important subject, bearing not only on Africa but also on the United States' interests in Africa. I also think you're going to find parallels perhaps between what my colleague and I say about China's strategy and role in Africa and what you'll find in Latin America and perhaps other parts of the world.

China, of course, has had a long involvement in Africa right from the beginning of African independence in the '60s. But what has changed and what I think we want to focus on is that in the last few years, China has emerged in a different way. It has emerged as a significant world player on the economic scene and with significant needs for oil, gas and other natural resources.

The Chinese returned to Africa in a sense not only with the need for economic resources but with a lot of cash to play the game dramatically and very competitively.

My colleague David Shinn will be illustrating in more detail East and Northern Africa, East Africa in particular, where he has had a great deal of experience. I will just mention briefly the Sudan situation because it illustrates how our objectives can come into competition with each other and how China is changing the strategic framework within which we operate in Africa.

You'll recall that under pressure from the U.S. and human rights groups, Western oil companies withdrew from Sudan because of the civil war there and the human rights depredations there only to be replaced by China and Malaysia. And David will speak more to that and their involvement in Sudan and the implications.

That will be a phenomenon that we'll be dealing with elsewhere in Africa. That is it's no longer possible for us to say to a country, well, you aren't doing what we want or what we think you should be doing, we will ban U.S. oil companies, et cetera, because with some exceptions that I will touch on in a minute, there's competitors out there and it's not just China. We have to realize it's China, it's India, Malaysia. Let me just give an illustration of that, and an illustration of how China operates in other countries. In West

Africa, China has become extremely active, particularly in the oil sector but not only in the oil sector, in other minerals and in non-mineral activities.

They're building a big luxury hotel in Sierra Leone of all places. They're in the pharmaceutical business, in the telecommunications business. Let me give you an illustration of how they come to a government with what one analyst has called the complete package: "We have the technology; we have the money, and we sit on the Security Council and therefore can protect you from Western pressures whether it's on human rights or anything else." We saw that mostly in Sudan.

But let me give you just an illustration from Angola. Angola is the second-largest producer in Africa of oil. Nigeria is the largest. We get about ten percent of our oil from Nigeria, somewhere about half that much from Angola, but those two countries will double their production in the next decade and of liquefied natural gas, West Africa is going to become a major producer.

China came into Angola and bid on an oil block and who is their number two competitor? It's India. The Chinese win. How do they win? Well, they win because they bid, but they also offer Angola a \$2 billion soft loan for development. I've just learned that they've added another \$2.5 billion to that. Now, how does that change the dynamics?

Well, as a colleague of mine from the international financial institutions was telling me the other day, the IMF arrived in Angola not long ago with its long list of all the reforms that should take place, and the Angolans said thank you very much and just put it over there. Because Angola had just received the second tranche of this \$4.5 billion commitment.

So we are in a different situation. If you look at Nigeria, it's just another example and there are more in the paper that you'll have a chance to look at in more detail later. In Nigeria where China has come in talking about as much as \$7 billion in investments, this is the largest country in Africa, the largest oil producer in Africa. China is bidding on oil blocks, but the Chinese have also offered to do something else. They've offered to take over one of the worst money losing propositions in Nigeria, one of the oil refineries steeped in waste, corruption and mismanagement. Nobody would take it if it's privatized.

The Chinese might take it, and they might take it not because they're going to make money on it in the near future, but because it positions them in a very critical way within the energy sector in Nigeria. They're also willing to invest in agriculture and a number of other areas. Nothing sinister about this. But what it demonstrates is the package of things with which they come to the table and offer real competition.

You can find that elsewhere. They also are willing to operate in conflict zones where Western companies would not be willing to go. They're very active in the Democratic Republic of Congo particularly for natural resources. You would think that nobody would be willing to go into a country racked by civil war. They're there. They're there actively.

And as I mentioned, China is building a luxury hotel in Sierra Leone that had one of the most brutal civil wars in history, but po-

sitioning themselves for future investments in Sierra Leone's mineral resources. In Angola, in the Cabinda region, which is the oil-producing area, the largest immigrant group in Cabinda is Chinese. So they put people on the ground.

They're also willing to bid on infrastructure projects and not worry about the profit. So they bid on a lot of infrastructure projects. David can speak better than I to Ethiopia where they are willing to bid at cost or lower to become players in those countries.

Joshua Eisenman on your staff has written about China's role in Zimbabwe where China is a major player, and where again like in Sudan, China is willing to support a rogue regime. And the Chinese boast about this. This is their way of operating. The Deputy Foreign Minister has said business is business—funny coming from a Marxist government—business is business. One of their officials put it this way: “We try to separate politics from business. You in the West, you've tried to impose a market economy, a multi-party democracy on these countries which are not ready for it. We are against embargoes, too, which you have tried to use against us.”

Now, in a broader strategic way, China's rising role doesn't endanger American security interests right off the bat. The global oil market, for example, sells on the international market wherever, whoever is producing it. But what it does do is change the strategic framework in which we're going to operate and the competitive framework for influence. This comes at a time when our interests in Africa are growing because of our growing sourcing of oil and gas from West Africa. We have to be concerned with good governance in oil producing countries. We have to be concerned with how those oil earnings are used. Otherwise, we will have more instability. This is the whole lesson we've learned now from the Middle East.

But here you have the Chinese saying; “We don't put any of those conditions on of good governance, human rights, etc. on our investments.” So we have a different situation, and we need different kinds of leverage. We have to enlist the Africans much more to be concerned about these issues and not to be just simply enticed away from them, as the Angolans seem to be.

Second, I think we have to think about opening a dialogue with the Chinese on Africa and perhaps other regions like Latin America. We have a lot on the agenda with China, as you know better than I, but are there rules of the road that we can begin to establish with the Chinese? They want to be players in the world. They want to play and be respected. The question is can they do that and still be supporters of outright rogue regimes? Don't they have a longer-term set of objectives in Africa? I think we've got to open that dialogue in any case, but I think we also have to be aware that we're in a new strategic and economic framework in places like Africa. They're competitors. And they've done a lot for Africa. India and China's demands on minerals have raised African earnings to the highest levels in years in copper and oil, so the Africans are very happy about that side of it.

They're not happy about the flood of Chinese goods coming in that have become a big source of controversy in South Africa, that

have undermined industry and employment in northern Nigeria. We are familiar with that problem here in the U.S.

But China is there, it is an important competitor, and we have to look at new ways of operating in Africa as a result. Thank you very much.

[The statement follows:]

**Prepared Statement of Ambassador Princeton N. Lyman
The Ralph Bunche Senior Fellow in Africa Policy Studies
Director of Africa Policy Studies, Council on Foreign Relations**

China's Rising Role in Africa

China has had a long involvement with Africa, going back to the early days of independence movements in the 1960s and before. But the current level and intent of China's involvement is different.

In those earlier days, China's intentions were primarily diplomatic, i.e. to counter recognition of Taiwan as the representative of China and thus to shore up votes for the eventual rejection of Taiwan's China credentials in the United Nations. China's other objective was to compete not only with Western influence but Russia's. In Zimbabwe, in the most obvious instance of this rivalry, China backed the liberation movement of Robert Mugabe, ZANU, while Russia backed that of Joshua Nkomo, ZAPU. Mugabe's ultimate election victory and his total vanquishing of ZAPU, laid the foundation for the close relationship that exists between China and Zimbabwe today.

In those early days China's presence was noted by lavish infrastructure projects, often with little economic development connection. All along the coastal countries of West Africa, one found the huge, Olympic-style stadiums that were the hallmark of Chinese donations. In eastern Africa, the competition was keener, with China financing and building the railroad in Tanzania, as the West built the nearly parallel road system. Throughout the next several decades, China provided technical expertise, doctors, scholarships, and various forms of aid. Today more than 900 Chinese doctors work in African countries.

Chinese influence and involvement nevertheless waned in the 1980s as it was unable to compete with Western aid programs and no longer was as fearful of Taiwan's presence—though reducing recognition of Taiwan remained (and remains today) an important Chinese objective. What has changed in recent years, however, is China's emergence as a significant world player on the economic scene and its own need for oil and other natural resources. China returns to Africa in the 21st century with not only a need for economic resources but with the cash to play the game dramatically and competitively.

David Shinn will be illustrating China's involvement in east Africa and the Horn. Suffice to say here that China has become the principal investor in Sudan's oil industry and related transport and infrastructure projects. China was able to do so because Western companies, in particular American and Canadian firms, were pressured to withdraw because of Sudan's civil war and charges of both persecution and use of slavery against the people of the south, including in the region of oil production. Sudan represents the clearest example of how China comes to Africa with what one analyst has called the "complete package:" money, technical expertise, and the influence in such bodies as the U.N. Security Council to protect the host country from international sanctions. China, together with its partner Malaysia, replaced Western companies and enabled Sudan to become a net exporter of crude. China has become its biggest customer. Meanwhile, China has successfully prevented the U.N. Security Council from serious sanctions or other preventive measures in face of the alleged genocide and crimes against humanity perpetrated in the Darfur region of that country.¹

China has more recently become a player in the energy field on the west coast of Africa, which is the largest producer of oil on the continent. West Africa provides the United States with 15 percent of oil imports and this is projected to grow to as much as 20–25% over the coming decade. Nigeria and Angola are the main producers and China has become active in both countries. Angola represents how China puts its assets together to build its presence. In connection with its bid to win rights to exploration of a bloc, China offered Angola a \$2 billion soft loan as part of a

¹ Cheryl Igiri and Princeton N. Lyman, *Giving Meaning to "Never Again." Seeking an Effective Response to the Darfur Crisis and Beyond*, Council on Foreign Relations Special Report, No. 5, September 2004, pp. 15–17.

longer term aid package. China won the bid, and—as an indication that China is not the only new player on the continent—the closest competitor was India.

It is not only protecting its clients from strong punitive measures by which China's investments are attractive to Africans, but also because they come with no conditionality related to governance, fiscal probity or other of the concerns that now drive Western donors. In Angola, as with Sudan, China's presence alters the international role. The IMF and Western countries have been pressing Angola to improve the transparency of its oil sector and to make other reforms as prelude to a planned donor's conference. By the end of June, however, Angola had failed to make sufficient reforms and the conference has been postponed. Angola seems less concerned with meeting the conditions, and the Chinese loan is seen as having had an influence. Angola's Ambassador to South Africa remarked that making transparency a condition for the conference was "uncalled for." He added that "political conditions" needed to be normalized first before the government could address the issues of fiscal transparency.²

China relishes this role. China's deputy foreign minister, Zhou Wenzhong, told an interviewer, "Business is business. We try to separate politics from business. . . . You [the West] have tried to impose a market economy and multiparty democracy on these countries which are not ready for it. We are also against embargoes, which you have tried to use against us."³

China has entered the Nigeria market as well. In July, China and Nigeria signed an \$800 million crude oil sale agreement setting in motion an annual purchase by China of 30,000 barrels a day for five years. Much more significant is that China has won a license to operate four of Nigeria's oil blocs, "as part of an incentive to build a hydro power station." Beyond this is China's willingness to take over a privatized oil refinery in Nigeria, a money losing proposition that no Western company would likely have touched. All in all China is reported to be considering \$7 billion in investments in Nigeria, covering a wide variety of sectors.⁴

The pattern is the same elsewhere. In Zambia, China has invested nearly \$170 million in the mining sector, primarily but not only copper. China is now the world's largest user of copper, with the U.S. second.⁵ China has been active in the Democratic Republic of the Congo, a country gripped by civil war and instability. Despite these conditions, China has begun investment in cobalt and copper mines, begun work on roads to facilitate mineral exports, and examined power projects as well. In another unstable country, coming out from a devastating civil war, Sierra Leone, China is developing a luxury hotel and making other investments—going in where others would fear to tread. In Uganda, a Chinese pharmaceutical firm is introducing a new anti-malaria drug and bidding on a contract to supply treated bed nets.⁶

China's indifference to political controversy is illustrated in its close relationship with Zimbabwe. China is the principal supporter of the Mugabe regime, which is reviled in the international community for Mugabe's ruthless crushing of the opposition and his most recent removal of hundreds of thousands of city residents to the rural areas, with no respect for life, health, or satisfactory alternative arrangements. China is investing in minerals, roads and farming, and supplying Mugabe with jets and other armaments. "Zimbabwe is all but owned by China," say some observers. "In return for a rare hand of friendship in an increasingly hostile world, Mugabe has offered Chinese companies almost anything they want, regardless of payback."⁷

The Other Side of the Coin

China's principal interest in the continent is access to natural resources. But it is not its only interest. China's economic interests are wider. China's trade with Africa has risen sharply, from \$10 billion in 2003 to \$20 billion in 2004 and another

²"Angola: Donors' Conference Likely to be Delayed Over Oil Accounts," *Southscan (London), NEWS*, June 30, 2005, posted to the web, July 6, 2005. <http://allafrica.com/stories/printable/2005070671.html>.

³Howard French, "China in Africa: All Trade and No Political Baggage," *New York Times*, August 8, 2004.

⁴Onyebuchi Ezigbo, "Nigeria-China Sign \$800 Million Crude Oil Sale Agreement," *This Day (Lagos)*, July 11, 2005. On the web at <http://allafrica.com/stories/printable/200507111391.html>. Dianna Games, "Chinese the New Imperialists in Africa," *Business Day (Johannesburg)* February 21, 2005. On the web at <http://allafrica.com/stories/printable/200502210104.html>.

⁵"China Scoops Up Minerals, Infrastructure Contracts," *SouthScan (London)*, June 30, 2005. Posted to the web July 6, 2005. <http://allafrica.com/stories/printable/200507060674.html>.

⁶Paul Busharizi, "China Firm to Launch Malaria Drug," *New Vision (Kampala)*, June 11, 2005, <http://allafrica.com/stories/printable/200506130419.html>.

⁷Games, *op cit.* For a fuller account of China's role in Zimbabwe, see Joshua Eisenman, "Zimbabwe: China's African Ally," *China Brief, The Jamestown Foundation*, Volume 5, Issue 15, July 5, 2005, pp. 9–11.

50 percent increase is expected in 2005. Chinese goods are flooding African markets, and—not so different from the United States—there has been growing concern in Africa about the effect on local industry. The primary focus is on textiles where the growth of Chinese exports constitutes a double whammy for Africa. Exports of Chinese textiles to Africa are undermining local African industry while the growth of Chinese exports to the United States is shutting down the promising growth of African exports in this field.

Southern Africa provides a good example of both effects. Chinese exports of textiles to South Africa grew from 40 percent of clothing imports to 80 percent by the end of 2004. Out of 100 T-shirts imported into South Africa, 80 are from China. In the same period, from 1996 onward, employment in the sector in South Africa has decreased. By the end of 2002, 75,000 had lost their jobs in the industry.

The impact on African exports comes from the ending of the Multi-Fibre Agreement (MFA), which had allowed countries like the United States to place quotas on clothing and textile imports from particular countries. Under that system, the United States had long put quotas on China. More recently, the United States enacted the Africa Growth and Opportunity Act (AGOA), which gave African countries almost unlimited access to the American market. Textiles was one of the fastest growing exports under AGOA, with rapidly growing industries in Lesotho, Swaziland, Ghana, Uganda, Kenya and elsewhere on the continent. Once the MFA expired in January 2005, however, Chinese exports to the United States soared and African exporters found they could not compete. More than 10 clothing factories in Lesotho closed in 2005, throwing at least 10,000 employees out of work. South Africa's clothing exports to the United States dropped from \$26 million in the first quarter of 2004 to \$12 million for the first quarter of 2005.⁸

South African industrialists and workers have clamored for protective action, joined by church leaders and opposition leader Tony Leon. Textile workers joined other workers in a nationwide strike June 27 to protest job losses. The trade union federation, COSATU, is calling for a restriction on Chinese imports, and is urging retailers to stock 75 percent of locally made goods. Industry is calling for customs officials to impound undervalued Chinese imports.⁹

The impact has been no less in West Africa. In Nigeria, low cost imports have largely devastated the textile and other consumer product industries of Kano and Kaduna. In these largely Muslim cities, one Nigerian parliamentarian described a frightening situation of vast numbers of unemployed youth, a powder keg in Nigeria's already fractured society. Given Nigeria's underdeveloped and unreliable supply of power, which forces most industries to rely on backup diesel generators, the prospect of Nigeria regaining a competitive edge seems remote.¹⁰ In Ghana, threats of closures have come from some of the leading industrialists. Reflecting the rise and fall of the effects of AGOA, the head of Gregory Knitting said, "We in clothing and manufacturing are seeing shocking times. Sales in 2003 were reasonable, they were better in 2004, and very bad in 2005."¹¹

If China has been forthcoming in aiding and investing in Africa with few strings and considerable cash, it has been equally firm in defending its export policies. China's Economic and Commercial Counselor in South Africa warned South Africans that "unfair and discriminative restrictions will never be accepted by China." He pointed out that China was within its rights under the WTO and had invested carefully during the ten years of the MFA to become efficient and competitive. "Thanks to the arduous efforts over the years, the Chinese textiles and clothing industry managed to sharpen its international competitive edge and gained the comparative advantages it now enjoys." If Africa needed to be told of the competition it now faced, he added that even if African countries placed restrictions on Chinese goods, they would not be able to control the substitute flow of goods from India and Pakistan. The solution, he said, was for South Africa to adopt a "positive attitude."¹²

The Implications for the United States

It would be easy, but mistaken, to build up the rising role of China in Africa as a new threat to the United States, or even to its interests in Africa, and thus make

⁸Amos Safo, "The Textile Saga: Workers Turn Heat on Government," *Public Agenda (Accra)*, June 27, 2005. On the web at <http://allafrica.com/stories/printable/200506271442.html>, and U.N. Integrated Regional Information Networks, "Southern Africa: Textile Industry Undone by Globalization," July 6, 2005. On the web at <http://allafrica.com/stories/printable/200507070004.html>.

⁹Safo, *op cit*.

¹⁰Princeton N. Lyman, *Nigeria's Economic Prospects: An International Perspective*, Address to the Nigeria-U.S. Investment Conference, Abuja, Nigeria, September 17, 2004. Available at www.cfr.org.

¹¹Amos Safo, *op cit*.

¹²Ibid.

China an “enemy” there. What is necessary is to recognize that the rising economy of China, and nearly as significant those of India and other Asian countries, changes the strategic and economic playing field in Africa. It is not dissimilar to the impact of those economies in Latin America where many of the same phenomena are taking place.

In many ways the economic growth in Asia, and the subsequent growth in demand, is good for Africa. Mineral prices are reaching record highs, reversing a long decline for many of Africa’s major exports over the past few decades.¹³ For Africa’s oil producers, there has been a substantial windfall. Nigeria might not have been able to negotiate such a favorable debt relief program from the Paris Club as it has just done, eliminating some \$18 billion in debt, if it had not been in a position, because of recent oil windfalls, to put \$6 billion on the table to clear interest and past arrears as part of the deal. China is also investing in areas that Western aid agencies and private investors have long neglected: physical infrastructure, industry, and agriculture. These are areas that the West, recently fixed on social needs in education and health, had largely abandoned, and only now again has recognized as essential for Africa’s growth.¹⁴ Finally, China offers African nations some competition to the west, emboldening some leaders to take a harder look at the conditionality of the IMF and other institutions, advice that may or may not be the best for their circumstances.¹⁵

China poses a particular challenge, nevertheless, to the ways in which the United States has sought to maintain and utilize its leverage. China utilizes a variety of instruments to advance its interest in ways that Western nations can only envy. Most of China’s investments are through state-owned companies, whose individual investments do not have to be profitable if they serve overall Chinese objectives. Thus the representative of China’s state-owned construction company in Ethiopia could reveal that he was instructed by Beijing to bid low on various tenders, without regard for profit. China’s long term objective in Ethiopia is in access to future natural resource investments, not in construction business profits. In other cases, China can use aid, investment and technical inputs to win long term gains and access, with a willingness to “lose” much in the short run to gain in the long run. In Kenya, China’s largest telecoms manufacturer, ZTE Communications, made a “gift” of equipment worth 144 million Kenyan shillings to Telkom Kenya, saying it hoped to play a positive role in Kenya’s telecommunications industry.¹⁶ China’s interest in taking over Nigeria’s Kaduna refinery, an installation steeped in corruption, waste and decay, can only be seen in this light.

Not only is this a challenge to American and other foreign businesses seeking contracts on the continent, China challenges areas where U.S. political leverage was once greatest. This is particularly true in the oil and gas sectors. Once the United States could threaten rogue states with barring American, and with pressure, other Western countries’ oil companies from exploration and production in those countries. This is precisely what happened in Sudan in the 1980s and 1990s, with Canada the last Western country shamed out of the sector. Yet China and Malaysia quickly filled the vacuum. Recently Congressional Members roundly criticized Western oil companies for undertaking lucrative business in Equatorial Guinea, a small country with a poor human rights record. Yet the truth is that Equatorial Guinea would quickly have other suitors, should Western companies depart. American oil companies have seen the writing on the wall. In Angola, BP and China’s state-owned oil company have entered into a joint venture. In Angola’s oil-centered Cabinda province, ethnic Chinese are the largest immigrant group.

Less dramatic than gross instances of human rights violations, the West’s most recent concern has been with enhancing transparency in the oil and mineral sectors of developing countries—e.g., the Extractive Industries Transparency Initiative led by the United Kingdom with strong U.S. support. This is vital to the stability as well as the long term health of those nations. But as we have seen, Angola has been able to resist such pressure, in part at least because of Chinese largesse. It is not only in the oil sector that leverage is being reduced. As noted above, China is basically bailing out Zimbabwe in the face of international sanctions and criticism.

¹³In June 2005, copper prices rose to their highest level in 16 years. Kingsley Kaswende, “Copper Prices Continue to Rise,” *The Post (Lusaka)*, June 8, 2005. <http://allafrica.com/stories/printable/200506080487.html>.

¹⁴Center for Global Development, *Assessing the G-8 Summit*, <http://www.cgdev.org/G8.cfm?Print=yes>.

¹⁵See for example, Joseph E. Stiglitz, *Globalization and its Discontents*, W.W. Norton, New York, 2002, pp. 3–88.

¹⁶Games, *op cit*.

American interests are not yet seriously threatened. American oil companies still dominate in the offshore technology that is at the heart of West Africa's growing energy production. And the United States still imports substantially from African oil and gas producers, with the market controlled more by international price and demand than by individual country manipulations. But the United States does have to recognize that the United States, and the Western nations altogether, cannot consider Africa any more their *chasse garde* as the French once considered francophone Africa. There is a new strategic framework operating on the continent and it demands new ways of operating.

In terms of promoting political and economic reform, now so much the parlance of both political and development thinking, the major impetus must come from Africans themselves. The United States can do much to encourage that, with aid targeted to judicial reform, democratic institutions, the Parliament and Human Rights Court of the Africa Union, and African civil society. Providing truly large amounts of aid over several years, to reward good performing countries—the philosophy of the Millennium Challenge Account but not yet realized—is another promising initiative. Both the United States and Europe also still have one more major economic card to play: opening their markets to African agricultural products. The benefit to Africa could dwarf all that China and India together could do for Africa's development. But the EU and the United States are held back from playing this card by domestic pressures, despite regularly stated pledges to take the necessary action. If we are serious about Africa, and going beyond humanitarian aid and charitable impulses, this is the most valuable step we can take.

Finally, the United States should begin to engage China on Africa. China has more than economic objectives. China is seeking to be recognized as a major power. It has become more active in supporting U.N. activities, including the provision of peacekeepers to the U.N. It rarely vetoes U.N. resolutions (unless recognition of Taiwan is at stake) even when it has reservations. In March of this year, China abstained rather than veto a U.N. Security Council resolution asking the International Criminal Court to investigate human rights violations in Darfur and setting in motion a process that could lead to sanctions against Sudanese officials. In sum, China seeks its place in the sun, including respect.

The question then is does China want to be seen in Africa as the defender of rogue states, the more aggressive seeker of Africa's natural resources, without regard to transparency, development and stability there? Is there room for developing some rules of the road, some common objectives, some ways in which Chinese economic gains for Africa (and itself) can come side by side with building more stability and democracy there? Are there incentives—more joint ventures, more common work on both the exploitation and preservation of natural resources in Africa (e.g., the rain forests)—that the United States can offer? In sum, are there more areas of win-win situations in Africa for both the United States and China? It is better to explore these possibilities than to start down the path of trying to limit Chinese influence, for the odds are against that happening any time soon.

Cochair BARTHOLOMEW. Thank you. Ambassador Shinn.

**STATEMENT OF AMBASSADOR DAVID H. SHINN
ADJUNCT PROFESSOR
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Ambassador SHINN. Thank you, Madam Chairwoman. I think it's important to understand from the beginning that China has a very long historical relationship with Africa that goes back centuries and they're very proud of that fact. They've also had a relationship in more recent decades which has gone through the various political vicissitudes of the Sino-Soviet conflict, conflict with the United States, and now you have the post-Cold War situation where there is at least the possibility of greater cooperation between the U.S. and China.

China has a little bit of an advantage in terms of dealing with the developing world in that it is a member of the so-called Group of 77, now called the Group of 77 plus China, which is actually about 130 different countries, and that gives them an advance that's not open to the United States or other Western countries.

I submitted a very long paper, and I'm certainly not going to read it. Basically, it is based on 14 countries in East Africa, North Africa and the Horn of Africa, and then trying to draw lessons from those 14 relationships. I would argue that the relationships, the trends that came out of the analysis pretty much apply to Africa as a whole, that is all 53 countries. I would just like to summarize what those lessons are.

China currently obtains 25 percent of its oil from Africa and within the region of Africa that I looked at, the 14 countries, Sudan is the major oil supplier, although China is now giving new and considerable attention to Algeria and Libya.

Trade with Africa constitutes only about three percent of its global trade, fairly small, but it's growing rapidly. It nearly doubled between 2000 and 2004. By the end of this year, China is expected to become Africa's third most important trading partner after the U.S. and France. Its five largest trading partners in order of importance are South Africa, Angola, Sudan, Nigeria and Egypt.

African exports to China totaled about \$16 billion in 2004 while Chinese imports reached about 14 billion. So for the moment, China has a trade deficit with Africa, but this is very misleading because it has enormous deficits with several of the oil exporting countries and it has considerable trade surpluses with virtually every other country on the continent. The countries that have the deficits in Africa are very concerned about what that means for their own economies. So there is some tension built in to this trade relationship.

China has also been a major supplier of military assistance to some, not a lot, but to some African countries. The information on that is very sketchy. It's very difficult to get hard statistics.

Foreign aid has been an important part of Chinese involvement in Africa, going all the way back to the 1960s. The amounts are modest. But the projects tend to be quite visible. They started out in the '60s and '70s with showy national stadiums and people's palaces. Now they tend to be more practical things, like roads, dams, government buildings and that kind of thing.

The Chinese have a long track record of sending medical teams to Africa. They've since 1963 sent a total of about 15,000 Chinese doctors. They have a long history with student scholarship programs which are expanding. Since 1956, they've sent some 15,000 African students to study in China. They are relying more and more on their commercial contacts using Chinese companies, most of which have connections with the state, and they're trying to break into the commercial markets throughout the continent. They're doing it with some considerable success.

And as Princeton indicated, they're often linking soft loans to some of these activities. Cultural exchanges and sports cooperation are very important in their activity. Increasingly important is the role of China in African peacekeeping. By the end of 2004, there were 840 Chinese peacekeepers in seven U.N. missions in Africa. They had contributed a total of 1,500 peacekeepers to nine U.N. missions in Africa since it began this policy.

Most of the African countries support China's policy on Taiwan and generally agree with China on a range of international issues. China also supports Africa's efforts to prevent and combat ter-

rorism. Many African countries, in part because they have similar human rights issues are sympathetic to China's human rights situation, and there's sort of a mutual support group going on with many African countries and China on human rights.

China, which ranked 71 from the top of 145 countries on Transparency International's Corruption Perception Index, also finds it easier to do business in Africa in ways that the Africans may be more attuned to doing business as compared to what Western countries have to confront.

African and Chinese interests in the WTO will sometimes be at variance as recently happened in the case of textile exports. Nor is there going to be agreement on all political issues. For example, China has not signed the Ottawa Treaty banning land mines; and most African countries prefer that ban.

China has not signed Kyoto. For the most part, the African countries give lip service to it. China does have one very important operational disadvantage in working in Africa. Most Chinese only speak Chinese and you have to work in English, Portuguese, French or Arabic in Africa if you want to get the job done.

What does China want out of all of this? Well, it wants access to natural resources, especially oil, but also gas, copper, iron, fish, timber, et cetera. It wants to sell goods and services in a market that totals more than 870 million people and is growing rapidly, although it's poor. It wants legitimacy for its one-China policy, understanding for its approach to human rights, and votes in organizations like the United Nations and its specialized agencies, IMF, World Bank, WTO. It wants to be a major player on the world stage on its own, not Western terms. One way to achieve this is to develop geopolitical clout among Africa's 53 nations.

It is carrying out this campaign in large part now through the new China-Africa Cooperation Forum, created in 2000. It met for the first time in Beijing, then met in Addis Ababa in 2003 and it meets again in 2006 in Beijing.

If I could just wrap up by making a couple of comments on the China-Africa-U.S. relationship. Inevitably, there is going to be an element of competition between China and the U.S. in Africa over access to natural resources, winning of commercial tenders and even African support for occasional different positions on political, economic and social issues in international forums.

There will be disagreements, for example, on human rights issues in certain African countries on the priority and pace of democratization, in the sale of military equipment to African countries engaged in conflict, but I agree with Princeton Lyman that the U.S. should focus on those areas where American and Chinese interests converge. I think is possible in the case of cooperation on combating disease on the continent, improving education, combating African crime rings and international terrorism, and to some extent perhaps even combating domestic terrorism in Africa.

I think it should be possible to identify a range of issues on which the interests of both countries converge.

Thank you.

[The statement follows:]

**Prepared Statement of Ambassador David H. Shinn
Adjunct Professor, Elliott School of International Affairs
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China's Approach to East, North and the Horn of Africa

Some Perspective

China is currently engaged in a major effort to ensure access to natural resources, especially oil, as it expands relations in East, North, and the Horn of Africa. But it would be a huge mistake to focus exclusively on access to oil and natural resources as the reason for China's increased engagement in the region. Chinese links to this part of Africa are longstanding. China has a trade relationship with the region that Chinese scholars date back to the Han dynasty between 202 BC and 220 AD. Goods from China reportedly arrived in Meroe in northern Sudan via Red Sea ports during this period. The Kingdom of Axum in present day Ethiopia may have exported at the same time exotic products to China. Some African scholars are skeptical that contact between China and East Africa and the Horn began this early but generally concede it was underway by the 6th century.

China's interest in Africa increased significantly after 1949 as it began to move from a regional power to a global one. As growing numbers of African countries became independent in the late 1950s, China determined to extend its influence throughout Africa. This included strong support for African liberation movements, a policy that independent African governments recall favorably to the present day. During the Cold War, China competed with both the West and Soviet Union for influence in independent Africa. By 1970 China had established diplomatic relations with all the countries (Algeria, Egypt, Ethiopia, Kenya, Morocco, Somalia, Sudan, Tanzania, Tunisia, and Uganda) in the region except Libya. Formal relations with Libya took place in 1978 and with the Comoro Islands, Djibouti, and Eritrea as they became independent. China has an embassy today in all of these countries except Somalia, where security conditions preclude resident diplomatic personnel. Even the U.S. does not have an embassy in the Comoro Islands and returned its personnel to Sudan and Libya only fairly recently. Although the depth of China's relations with these fourteen countries has varied considerably, it has since the early 1960s employed the full range of political, economic, military, cultural, and educational tools to build ties. There were periods, particularly in the late 1970s and early 1980s, when African political elites were less responsive to revolutionary struggle and China reduced its activity in Africa. Since the end of the Cold War, China shifted from a focus on encouraging ideological allies in the region to an emphasis on access to natural resources, commercial ties and political influence. This has been especially true since the Chinese economy became so strong. In the last several years China noticeably extended its influence in all fourteen countries. China now has a more important relationship than the U.S. with Sudan and is a major competitor in several other countries.

In one respect, China occupies an enviable position in international politics today. It is accepted by developing countries, including most in Africa, as one of them while holding a permanent seat on the U.N. Security Council. It is seen by some in Africa, therefore, as their protector on the Security Council. Many others view China as a basically agricultural country that has managed to industrialize and from which they can learn many lessons. The developing countries have formalized China's acceptance by including it in the Group of 77 plus China. Created as the Non-Aligned Movement in 1964, the Group of 77 plus China actually includes more than 130 countries and held its first summit in Havana in 2000. A debating forum that reaches "decisions" by consensus, it tends to emphasize issues such as globalization, South-South partnership, and North-South relations. Unlike the other permanent members of the Security Council, China's unique situation allows it to interact with developing countries with relative ease.

Themes in China's Relations with Africa

This analysis looks at China's relations with Africa from the standpoint of fourteen countries in East, North, and the Horn of Africa. The trends that apply to these nations, which represent a good mix of those on the continent, arguably apply to all of Africa. China is the second largest energy consumer after the U.S., obtains 25 percent of its energy from oil, and is forecast to import 50 percent of its petroleum needs within a decade. China currently obtains 25 percent of its oil from Africa, which also has a high proportion of the most desirable sweet crude. Within this region of Africa, Sudan is a major oil supplier and China is focusing new attention on Algeria and Libya. Looking to the future, China is doing seismic work in

Ethiopia, remaining active in Somalia, which is known to have gas reserves, and collaborating with Egypt on energy development.

Although China's trade with Africa constitutes only about 3 percent of its global trade, it is growing rapidly. It increased by 700 percent in the 1990s and nearly doubled between 2000 and 2004. By the end of this year, China is expected to become Africa's third most important trading partner, after the U.S. and France. Its five largest trading partners in order of importance are South Africa, Angola, Sudan, Nigeria, and Egypt. African exports to China totaled about \$16 billion in 2004 while Chinese imports reached about \$14 billion. This African trade surplus is, however, highly misleading. Oil suppliers such as Angola, Sudan, and Nigeria had huge trade surpluses with China while virtually every other country had a deficit. The governments in many of these poor African countries are deeply concerned by these sizeable deficits. To counter this problem, China agreed in 2005 to exempt from tariffs certain commodities from twenty-five least developed African countries. One technique China uses to build export growth is the offer of modest amounts of free equipment, especially communications, with the goal of eventually selling larger quantities. China continues to be a major supplier of military assistance to African countries and gives senior level military exchanges a high priority.

Foreign aid has been an important but modest part of China's efforts to curry favor in Africa. Projects have tended to move away from showy national stadiums and People's Palaces to more practical roads, dams, and government buildings. The sending of medical teams and agricultural specialists continues to be a mainstay of its assistance to Africa. More than 15,000 Chinese doctors have worked in Africa since 1963. China is increasing student scholarships to study at universities in China and has made a special effort to cultivate relations with select African universities. Since 1956 more than 15,000 African students have studied in China. Increasingly, however, China is relying on its commercial enterprises, many of which have close ties to the state, to win contracts. They sometimes bid low in order to break into the market and don't always seem to be concerned about turning a profit. China also continues to offer soft loans. Investment in Africa by Chinese companies, totaling more than \$1.5 billion in 2004, is relatively small but growing. Cultural exchanges and sports cooperation also remain an important part of China's program in Africa. An area to watch is tourism, especially in East Africa. As Chinese increasingly are able to afford overseas travel and the government approves additional African countries as destination status for Chinese tourists, it may change the tourism pattern. China is playing an increasingly important role in African peacekeeping operations. By the end of 2004 there were 840 Chinese peacekeepers in seven U.N. missions in Africa and China had contributed a total of about 1,500 peacekeepers to nine U.N. missions in Africa since it began this policy.

Most African countries support China's policy on Taiwan and generally agree with its position on a wide range of international issues. China supports Africa's efforts to prevent and combat terrorism, including adoption of a counterterrorism convention and establishment of an anti-terrorism research center. Many African countries, in part because they experience similar criticism, are sympathetic to China's human rights policies. Nor will China be leading any campaign to encourage democratization in Africa, a policy that appeals to those governments in Africa that remain autocratic. China, which ranked seventy-one from the top out of 145 countries on Transparency International's 2004 corruption perception index, also finds its way of doing business closer to most African nations than is the case for Western countries. On the other hand, African and Chinese interests in the WTO will sometimes be at variance as recently happened in the case of textile exports. Nor is there agreement on all political issues. Most African countries prefer a ban on landmines; China has refused to sign the Ottawa treaty banning landmines. China, one of the world's leading polluters, has not signed the Kyoto Protocol. Many African countries at least give lip service to Kyoto. China must also cope with one major operational handicap in Africa. It has a limited number of nationals who speak fluent English, French, Portuguese, or Arabic; Chinese will just not do the job.

What does China want for all of its effort in Africa? It wants access to natural resources, especially oil but also gas, copper, iron, fish, timber, etc. It wants to sell goods and services in a market that totals more than 870 million people and is growing rapidly. It wants legitimacy, support for its one China policy, understanding for its approach to human rights, and votes in organizations like the U.N. and its specialized agencies, IMF and WTO. It wants to be a major player on the world stage on its own, not Western, terms. One way to achieve this is to develop geopolitical clout among Africa's fifty-three nations.

China-Africa Cooperation Forum

The China-Africa Cooperation Forum (CACF) has become the mechanism by which China is coordinating its activities in Africa. It is a consultation and dialogue forum for China and the African countries with a focus on South-South cooperation and issues of globalization. The first CACF ministerial meeting took place in Beijing in 2000 where the participants adopted the Beijing Declaration and the Program for China-Africa Cooperation in Economic and Social Development. The Forum meets at the ministerial level every three years and holds a high level preparatory meeting a year before the ministerial. The second ministerial took place in Addis Ababa in 2003 with forty-four African delegations. Premier Wen Jiabao announced that China had cancelled the debt of thirty-one African countries totaling \$1.3 billion and laid out a program for advancing China-Africa cooperation. He called for more high-level exchange visits, support for the New Partnership for Africa's Development (NEPAD), and promised China will increase participation in U.N. peacekeeping operations in Africa. He supported Africa's position on multilateralism, elimination of trade barriers and farm subsidies, increased aid, and debt relief by the developed countries. He promised China would gradually increase aid to Africa, provide professional training for 10,000 Africans over three years, grant duty free access to Africa's least developed countries, increase tourism, and encourage Chinese firms to invest in Africa. More than 150 Chinese entrepreneurs and 250 from Africa participated in the concurrent China-Africa Business Conference. According to press accounts, this side event resulted in the signing of agreements or understandings for twenty projects in Africa totaling \$680 million.

CACF hosted a seminar on human rights in Beijing in 2004 for delegations from twenty-seven African countries. The goal was to develop a consensus on human rights issues, coordinate their positions on international human rights, and improve the human rights situation in their own countries. This was clearly an effort by China to join forces with certain African countries that have a similar approach to human rights issues. A high level preparatory meeting for the third ministerial will take place in Beijing in August 2005 and the CACF ministerial is scheduled for Beijing in 2006. Ethiopia's Prime Minister Meles, joint chair of the CACF since the second ministerial, urged that the next session focus on capacity building, training professionals for Africa, trade, and investment. CACF seems to be off to a strong start and playing the role intended for it by China.

Kenya

China established relations with Kenya at independence in 1963. During the Cold War, the ties were not especially close. Although economic links have improved significantly in recent years and Kenya has always supported a one-China policy, Kenyan officials are concerned about the country's huge trade deficit with China and the recent negative impact of Chinese textile exports on its own industry. Kenya wants China to transfer its technology rather than use the country as a market for finished goods. Persons in the Kenyan textile industry refer to competition from China as the "Chinese tsunami." Chinese scales of economy, sophisticated factories, and low wages paid to workers threaten to overwhelm the advantages that African countries received from the U.S. as a result of the Africa Growth and Opportunity Act (AGOA). The decision in 2004 by the World Trade Organization (WTO) to remove quota restrictions from the Multi-Fiber Agreement added to Kenya's problems. Six thousand Kenyan textile workers have lost their jobs as a result of competition from China and India; six factories shut down. Kenyan textile exports to the U.S. in the first quarter of 2005 dropped 13 percent as compared to the first quarter of 2004. After the expiry of WTO quotas, most Asian companies that invested in Africa's textile industry to take advantage of AGOA left.

The larger Chinese-Kenyan relationship is more positive. Over the years China has undertaken a number of assistance projects including construction and subsequent rehabilitation of the Moi International Sports Center, a methane generating pit, construction and expansion of the Eldoret hospital, drilling of bore holes, road construction, and upgrading the power distribution system. Commercial ties have developed significantly in recent years. Although Chinese investment in Kenya totaled a modest \$53 million in 2003, thirty new Chinese companies reportedly invested there in the first half of 2004. China is especially aggressive in pursuing tenders for construction projects and sale of equipment. It frequently provides modest quantities of free equipment in order to lay the ground for much larger subsequent sales. For example, it donated computers to the National Assembly, communications equipment to Telkom Kenya, and TV equipment to the Kenya Broadcasting Corporation. Kenya is the communications gateway to East Africa. China understands the importance of breaking into the market. China has won many tenders in Kenya such as a contract with Telkom Kenya to install 26,000 switching

lines, the improvement of telecommunications facilities at Safaricom, and the sale of cranes for the port of Mombasa. When they lose bids they believe they should have won, Chinese firms complain publicly as happened when China lost the bid to supply meters to the Kenya Power and Lighting Company.

China designated Kenya as a preferred tourist destination and Kenya now seeks to tap into what it hopes will be a flood of Chinese tourists. As a result, Kenya Airways plans to open a new route to Shanghai this year. The two countries recently signed an agreement for the exploration of oil and natural gas in Kenya and another to increase the sale of coffee to China. There has been long standing cooperation in higher education with small but growing numbers of Kenyans studying in China. Chinese universities collaborate with Jomo Kenyatta University, Nairobi University, and Edgerton. China plans to teach Chinese at the last two. China and Kenya have agreed on a training exchange program for athletes prior to the 2008 Beijing Olympics. China has an active cultural program in Kenya that emphasizes Chinese culture and history. It has had a branch of Xinhua (Chinese News Agency) in Nairobi since 1985 and military exchanges are increasing. President Kibaki commented early in 2005 that Kenya is looking closely at China's development model to achieve quick economic growth.

Uganda

The establishment of diplomatic ties in 1962 did not lead initially to close cooperation. Only when the current Ugandan government came to power in 1986 was there a significant improvement. Today Uganda regularly reaffirms support for the one-China policy. China has financed rice projects, an ice plant, methane generating pits, the national stadium, rehabilitation of military barracks, and the new ministry of foreign affairs. Chinese companies are now active in housing projects, road and bridge construction, managing a Ugandan company that manufactures ammunition, and construction of offices for the Uganda bureau of statistics and computer services. Discussions are underway for additional projects and 100 representatives from Ugandan small and medium businesses are scheduled to visit China later this year.

Chinese trade with and investment in Uganda remain modest. Uganda suffers from a large trade deficit with China. Starting in 2005 China added Uganda to the list of countries that can export duty and quota free 187 products. The Kampala City Traders Association has complained that some Chinese "investors" are taking advantage of their status and are really no more than petty traders who compete with Ugandans. China included Uganda among its preferred tourist designations. This has raised hopes and led to an optimistic prediction from President Museveni that two million Chinese tourists are expected to visit Uganda annually beginning in 2010. Negotiations are underway for a direct flight between Uganda and China. Uganda hopes to step up training of its professionals in China and Makerere University has signed an agreement with a Chinese company to teach Chinese. China has been sending medical teams to Uganda since 1983 and has trained well over 200 Ugandan students in China. The Communist Party of China is working to strengthen relations with Uganda's ruling party. High level military exchanges remain modest.

Tanzania

Tanzania and China made an early decision to develop close relations following the formal establishment of ties in 1961. Tanzania's first President, Julius Nyerere, visited China five times during his Presidency. Tanzania actively supported China's efforts to occupy a seat on the U.N. Security Council. The two countries have maintained extensive political, economic, military, and cultural cooperation. President Mkapa led the Tanzanian delegation to the 2000 ministerial meeting of the China-Africa Cooperation Forum in Beijing. He emphasized the special relationship the two countries have had since the 1960s when China was Tanzania's closest ally during the struggles against colonialism and apartheid. Mkapa also noted that Tanzania and China enjoy the same outlook on almost all international issues of significance.

From the beginning, Tanzania has been China's largest aid recipient in Africa. Among the many projects funded by China was construction of the 1,153 mile long Tanzania-Zambia railway from Dar es Salaam to Kapiri Mposha in Zambia. A project during the height of the Cold War, the U.S. financed part of a road that ran parallel to much of the railway track. During its construction, China sent 50,000 technicians and workers to Tanzania and Zambia; at the peak there were 16,000 Chinese working on the railroad. Other major projects have included a textile mill, rice farm, coal mine, and sugar cane factory. More than 40 Chinese companies are operating in Tanzania. Current trade between the two countries is surprisingly modest, but results in a major deficit for Tanzania. Over the years the two countries have signed

many agreements on a range of issues. High level visits have been frequent and constant. Military exchanges and cooperation began in 1964 and continue to be an important part of the relationship. China has sent many medical teams to Tanzania over the years and a significant number of Tanzanian students has studied in China; there were 80 Tanzanian students in 2003.

There has been no decline over the years in the relationship. China agreed in 2004 to build and cover half the cost of a national stadium in Dar es Salaam. China provided an \$11 million loan to Tanzania and Zambia to rehabilitate the Tanzania-Zambia railway. From 2002–2004, China actually had the highest number—456—of legal migrant workers in Tanzania, exceeding the number from neighboring Kenya. China builds goodwill by regularly making modest donations such as \$100,000 following tsunami damage along the Tanzanian coast and an even smaller sum for anti-malaria drugs. Chinese companies routinely bid on tenders. This has become a highly developed and mature relationship with strong roots back to the 1960s.

Comoro Islands

China established relations with the Comoro Islands in 1975 and, unlike the U.S., maintains a resident embassy there. China has implemented a number of modest aid projects in the Comoros, including a water supply project, the construction and subsequent refurbishing of the People's Palace, government office buildings, the TV broadcasting headquarters, and renovation work at the international airport. Trade is miniscule and all one way from China to the Comoros. Chinese medical teams have visited the islands since 1994 and small numbers of Comorian students study in China. The first visit by a Chinese minister of foreign affairs occurred in 2004. The Comoros supports China's anti-secession law and its one China policy. China pays a small price for strong support in international forums.

Sudan

China established relations with Sudan in 1959, but several decades passed before the ties became truly important. A pro-Soviet Communist party in Sudan and the Sino-Soviet conflict occasionally complicated relations in the early years. When the Sudanese Communist party was implicated in a failed coup attempt in 1971 against the Nimeiri government, China took advantage by offering to supply military equipment and train the armed forces. China has been an important supplier of arms to various Sudanese governments ever since. Weapons deliveries from China to Sudan have included ammunition, small arms, towed howitzers, anti-aircraft guns, anti-personnel and anti-tank mines, tanks, helicopters, and fighter aircraft. China provided soft financing for some of these purchases. China helped establish three weapons factories in Sudan, including one for assembling T-55 tanks. Since the mid-1990s, the supply of arms has been linked to the supply of oil to China.

The China National Petroleum Corporation (CNPC) took a 40 percent interest in 1996 as part of a consortium to develop Sudan's oil production in the Heglig and Unity fields. In 1998 the CNPC's construction arm participated in the building of a 930-mile long pipeline from these oil fields to the Red Sea. It also built a refinery near Khartoum with a 2.5 million ton capacity. At one point, China had 10,000 laborers in Sudan to complete these projects. This led to some complaining from unemployed Sudanese. China controls most of an oil field in southern Darfur and 41 percent of a field in the Melut Basin. Another Chinese firm is building a pipeline from that field to Port Sudan where China's Petroleum Engineering Construction Group is building a \$215 million export tanker terminal. Sudan became China's first major overseas oil development project. China now obtains 7 percent of its oil imports from Sudan and the percentage is growing. As a result, Sudan is the only country among those included in this survey that has a huge trade surplus with China. Chinese investment in Sudan totals about \$4 billion, most of it in the oil sector, which makes China Sudan's largest foreign investor. There are also an undetermined number of Chinese military personnel in Sudan to secure its investments.

Economic cooperation outside the oil sector includes a \$400 million project by Harbin Power of China to build seven electric substations and 1,000 miles of transmission lines. China provided 75 percent (\$200 million) of the financing to construct the Kajbar dam at the Nile's second cataract and Chinese companies are part of a consortium to build public works projects in connection with the dam. Sudan signed agreements this spring with China to construct a \$345 million pipeline that will channel water from the Nile to Port Sudan and to finance a \$325 million water system for the town of Alfashir. Another agreement signed in June will result in three major power stations. Sudan's foreign minister commented in Beijing recently that "China is the number one economic partner of Sudan."

Political cooperation is also an important part of the relationship. Sudan strongly supports China on its one China policy and its position on human rights. In return, China has helped to deflect Western criticism of Sudan's actions in Darfur. Human Rights Watch argued that China's oil purchases and arms sales helped fuel the conflict in Darfur. Although China did not succeed in stopping U.N. sanctions against Sudan, it managed to water down U.S.-drafted resolutions to the point that it abstained when they came up for a vote in the UNSC. When the UNSC proposed to refer the situation in Darfur to the Prosecutor of the International Criminal Court (ICC), China abstained together with the U.S., Brazil, and Algeria. China announced last March that it will provide military and medical personnel for the U.N. peacekeeping operation in support of the peace agreement between the Sudanese government and the Sudan People's Liberation Movement. President Bashir earlier this year commended China for its backing of Sudan in international forums and its effort to promote bilateral ties for their common interests.

Ethiopia

Ethiopia, due in part to pressure from the U.S., did not establish relations with China until 1970. Emperor Haile Selassie then visited Beijing the following year. The relationship did not flower immediately. After the overthrow of Haile Selassie in 1974, China briefly cultivated the new military regime. By 1977, the Soviet Union abandoned its Somali ally and Ethiopia's enemy, and replaced U.S. influence in Ethiopia. China, to Ethiopia's consternation, then replenished Somalia's military with jet fighters and small arms. China also provided a small quantity of assistance to the Eritrean Liberation Front, which sought independence from Ethiopia. Although China continued to seek good relations with Ethiopia, in view of its connection with Somalia and Soviet influence in Ethiopia, it faced a major challenge. Not able or willing to become Ethiopia's major arms provider, it stepped back and let the Soviets fulfill that role.

Relations began to improve after the overthrow in 1991 of Ethiopia's military government and have continued to grow warmer ever since. China was a significant supplier of military equipment to Ethiopia during its conflict with Eritrea in 1998–2000. This cooperation continues, including occasional visits by their respective ministers of defense. China has carried out a growing number of assistance projects, although increasingly they are commercial arrangements. They focus on road and bridge construction, power and water supply projects, irrigation, and housing. Chinese companies seize any opportunity for business. A Chinese company is conducting, for example, a \$5 million seismic study near the Sudan border and another company recently sold two ships valued at \$45 million to Ethiopian Shipping Lines. There are about seventy Chinese enterprises registered in Ethiopia. They often bid low in order to break into the market and are aggressive to the point of alienating Ethiopian competitors. The largest Chinese project in Ethiopia, construction of the \$300 million hydroelectric dam and power plant on the Tekeze River, has incurred the wrath of the government because it is behind schedule and the contractor has asked for an extension. The government is insisting that the consortium pay compensation for lost earnings due to the delay.

Trade is modest and heavily favors China. The imbalance has raised concerns in the Ethiopian government. In an effort to deal with this problem, China recently permitted Ethiopia to export a number of products duty and quota free. The two countries have signed a variety of agreements, mostly in the area of trade, investment, and economic cooperation. Beijing recently increased the number of Ethiopians sent to China on scholarship. Chinese medical teams and vocational education teachers also continue to be a mainstay in their cooperation program.

Ethiopia and China generally see eye to eye on political issues. They support each other on human rights questions. Ethiopia regards Taiwan as part of China. Although China walks a careful line on the Ethiopian-Eritrean conflict, it strongly endorsed last fall Prime Minister Meles' five point peace plan. During a visit to China in November 2004, Meles described relations with China as close, friendly, and substantial. The Ethiopian government sees China as a model for certain policies, especially rural development, poverty alleviation, and perhaps the banking sector. Not all Ethiopians agree that the Chinese model will work in the country and worry it will lead to sacrificing freedom and democracy. Ethiopia's minister of trade commented earlier this year that "China has become our most reliable partner." A recent analysis in *The Wall Street Journal* described China's influence in Ethiopia as "overwhelming." Addis Ababa is also the headquarters of the African Union, making it a useful location for China and others to stay in touch with delegations from throughout Africa.

Eritrea

China established relations with Eritrea at its independence in 1993. Although ties began well, they became complicated following the conflict that broke out between Eritrea and Ethiopia in 1998. China sold large quantities of military equipment to both countries during the conflict but has been careful to protect its more important investment with the much more populous Ethiopia. This has limited China's ability to expand significantly its links with Eritrea. Some half dozen Chinese companies are engaged in road and building construction. Trade is miniscule and consists almost entirely of Chinese exports to Eritrea. The two countries have signed a cultural agreement and China has provided training for Eritrean athletes. China offered some emergency relief, built a hospital in the capital, and periodically sends medical teams to Eritrea. High level military exchanges continue; China has helped with mine detection and clearance.

During a visit to Beijing in February 2005, President Isaias reaffirmed Eritrea's support for China's policy on Taiwan and its positions on human rights. Isaias praised Chinese assistance to Africa, saying it is sincere and comes with no political conditions. He added that Eritrea expects China to increase its involvement in construction of the transportation infrastructure and to expand cooperation in mining, fisheries, telecommunications, and technology.

Djibouti

A country of only a half million population, Djibouti and China established relations in 1979. There have been numerous high level visits involving their respective officials; Djibouti's former President visited China four times and the current President once. Djibouti and China have an agreement on economic and technical cooperation and China built the People's Palace, a stadium, an outpatient clinic, housing projects and the headquarters for the foreign ministry. Chinese companies are active in Djibouti. ZTE recently won the contract for extending the telecommunications infrastructure. For such a small country, Chinese imports are robust while Djibouti's exports to China are virtually non-existent. Small numbers of Djiboutian students study in China and Chinese medical teams are active in Djibouti. Representatives of Djibouti's ruling party participated in a seminar on Sino-African cooperation hosted by the Communist party of China in June 2005. Djibouti supports China's anti-secession law.

Somalia

Somalia and China have maintained close ties since they established relations in 1960. Somalia actively supported the seating of China in the U.N. during the early 1970s. Since Somalia became a failed state in 1991, China has been active in U.N. discussions on Somalia's future. Together with most other embassies, the Chinese embassy in Mogadishu closed for security reasons in 1991 but China continues to maintain diplomatic relations. When it was present in Somalia, China built the national theater, Hargeisa water supply, a cigarette factory, the national stadium, a hospital, roads, farms, and a power station. There were frequent exchanges of high level visitors until 1991. The two countries signed a number of economic and trade agreements and had an active cultural exchange that included coaches for Somali athletes. Chinese medical teams, military exchanges, and military assistance were also an important part of the relationship.

China provided at least \$1 million to help finance the recent Somali political reconciliation process in Kenya and reportedly continues to help fund the new Somali government that has not yet moved to Mogadishu. At first glance this support for a government that is having great difficulty taking up residence in its own country is surprising. On the other hand, it is a cheap way to be present at the beginning if the new government does take hold. Somalia has also sent an ambassador to China. The other major financial supporters of the Somali peace process are the U.N., European Union, and Kenya, but not the U.S. China noted that the new Somali government is an important step forward for Somali unity. The new Somali prime minister expressed appreciation to China for its support and willingness to assist a possible U.N. peacekeeping operation in Somalia. Recent Chinese aid to Somalia has been modest, consisting of emergency supplies following damage done by the tsunami and ninety generators for supplying power in the regions. Trade is also small, but Somalia is one of only two countries in this review that has a trade surplus with China, thanks to the export of fish.

Morocco

Although China and Morocco exchanged relations in 1958, ties developed slowly and faced challenges during China's Cultural Revolution. In more recent years there has been a significant expansion of ties. The two countries have signed numerous

agreements dealing with trade, investment, civil aviation, environmental cooperation, tourism, health, double taxation, animal and plant quarantine, etc. They established a mixed committee on economic, trade, and technology issues. Economic cooperation has been especially strong in fisheries. They even signed an agreement to hold regular political consultations. Morocco supports China's position on Taiwan. China has been sending medical teams to Morocco since 1975 and had 120 medical personnel in the country in 2003. China began sending students to Morocco in 1975 and has an office of Xinhua in Rabat. The Maghreb news agency in Rabat and Xinhua signed a cooperation agreement in 2002. High level exchange visits have been less frequent than is the case for many African countries although King Mohammed VI visited China in 2002 and the Chinese premier visited Morocco the same year.

Trade is significant but heavily favors China, which is sensitive to the situation and said it will try to increase the import of Moroccan phosphates, fertilizer and fish. Moroccan textile exports to Europe were hurt recently by Chinese competition. China also stated that it will encourage its enterprises to participate in the construction of Moroccan infrastructure. China provided Morocco with a \$5 million loan in 2003 to help finance public works projects and donated a modest amount of emergency assistance after the 2004 earthquake. Except for the many agreements they have signed and high volume of trade, China's engagement in Morocco is not as pervasive as one would expect for such an important African country.

Algeria

China has had a politically close relationship with Algeria since it recognized the Algerian interim government in 1958. Algeria reciprocated by helping China to obtain its seat in the U.N. Algeria has been a strong supporter of China's policy on Taiwan from the beginning. China began a series of projects in Algeria in 1980 in the fields of agriculture, water conservancy, and construction of hotels and restaurants. The two countries have a mixed committee for economic, trade, and technological cooperation and since 1997 they hold regular political consultations. They have signed about twenty agreements on culture, education, sports, and the media. China began sending medical teams to Algeria in 1963; more than 2,200 Chinese have worked in Algeria. There are surprisingly few Algerian students studying in China, only twenty-three in 2003.

High level visits have been a mainstay of the relationship. Most recently, President Hu Jintao visited Algeria in 2004. On the occasion, the two countries decided to "enter a strategic partnership" and strengthen cooperation in all fields. They emphasized oil and gas extraction, infrastructure construction, telecommunications, and training of personnel. China reiterated its support for Algeria's effort to join the WTO and Algeria declared that Taiwan "is an inseparable part" of China. Both sides firmly opposed terrorism in any form and supported the legitimate rights of the Palestinian people, including their right to establish a country with complete sovereignty. The two countries signed a \$48 million loan agreement. Representatives from Algeria and China's southern province of Guangdong signed agreements the same year valued at almost \$200 million for trade and investment projects. China's Huawei Technologies won a contract from Algeria Telecom Mobile to provide network equipment. ZTE Corporation is opening a wireless fixed terminal manufacturing plant in Algeria in an effort to penetrate more effectively the market in North Africa and the Middle East. Chinese companies are constructing 55,000 apartments, a teaching hospital in Oran, and a terminal at the international airport.

The most important recent development in Chinese-Algerian relations is China's move into the gas and oil sector. The China Petroleum and Chemical Company (Sinopec) signed a \$525 million contract in 2002 to develop the Zarzaitine oil field in Algeria's Sahara Desert. In 2003 the China National Petroleum Corporation (CNPC) purchased several Algerian refineries for \$350 million and signed a deal to explore for oil in two blocks awarded by the Algerian government. PetroChina Exploration and Development Company signed a contract with Algeria's Hydrogen Carbide to develop jointly oil fields and build a refinery in the southwest part of the country. This will allow the two companies to operate a refinery in Adrar for twenty-three years, with an annual output of 600,000 tons. In 2005 CNPC and Algeria's National Petroleum Company signed a \$400 million contract to complete a condensate topping project. As of 2003, China maintained a huge trade surplus with Algeria. Once significant amounts of petroleum products are moving to China, Algeria will likely experience a trade surplus with China.

Tunisia

China did not establish diplomatic relations with Tunisia until 1964. Tunisia provoked China by advocating a “two China” policy as the solution to China’s U.N. seat. China accused Tunisia of siding with U.S. imperialism in 1967 and, following Chinese meddling in Tunisia’s internal affairs, the entire Chinese embassy staff in Tunis departed for Beijing and there was a temporary break in relations. It took years to reestablish cordial ties. By the mid-1980s high level exchange visits had become more frequent and relations were back on track. The two countries agreed to periodic political consultations in 1996. On the occasion of President Jiang Zemin’s visit to Tunisia in 2002, they signed cooperative agreements dealing with economics and technology, maritime issues, civil air transport, double taxation, and culture.

Chinese companies are active in construction, agriculture, and light industry. They recently obtained contracts to build a gymnasium, water supply and sewage facility, ceramic factory, and others dealing with the environment and energy. China has sent medical teams to Tunisia since 1973 and has an active sports and cultural cooperation exchange. Agence Tunis-Afrique Presse began cooperation with Xinhua in the 1970s and the two organizations strengthened their collaboration in 2004. Tunisia has in recent years supported China on human rights, a one China policy, and considers Taiwan an inalienable part of China. A visit by the Chinese Vice President in 2004 resulted in loans totaling \$46 million and a gift of more than \$1 million. Trade is modest and consists largely of Chinese exports to Tunisia, which is another recent victim of falling textile exports due to competition from China.

Libya

Libya, prior to Qadhafi, had relations with Taiwan. Qadhafi “recognized” China in 1971 but did not establish diplomatic relations until 1978. Chinese atheism affected Qadhafi’s view of China, although he did visit Beijing in 1982. Today, Libya supports the one China policy and shares a common understanding on human rights. Chinese companies began operating in Libya in 1981 where they have been active in infrastructure projects. An agreement on science and technology and another establishing a joint committee on economic, trade, scientific, and technological cooperation came into force in 1982. They later signed cooperation agreements dealing with culture, information, and technology.

President Jiang Zemin visited Tripoli in 2002. The two sides agreed to facilitate cooperation in the fields of oil, investment, infrastructure, and tourism. Libya reaffirmed its one China policy while China stated that Libyan sanctions should be completely abolished at an early date. Libya and China said all forms of terrorism should be opposed and called on Israel to withdraw immediately its troops from Palestinian areas so that the Palestinian people could realize self-determination. China subsequently announced that it welcomed Libya’s decision to renounce weapons of mass destruction. When Chinese nuclear arms technology showed up in Libyan possession, China denied any nuclear cooperation with Libya. Pakistan’s top nuclear scientist admitted he had passed secret information to Libya that could be used to build nuclear weapons.

China is currently emphasizing commercial links, especially energy, with Libya. China exported 4,000 pickup trucks valued at \$21 million to Libya in 2003. This was China’s largest single export of vehicles since it joined the WTO in 2001. A Chinese communications company signed a \$40 million contract the same year to install a network of 600,000 mobile phone lines. Chinese trade with Libya was modest as of 2003 and heavily favored China. Serious discussions on oil and gas cooperation began in 2004. As a result of excellent South African business connections with Libya, PetroChina has been working with South African businessmen to penetrate the Libyan market. The commercial officer in the U.S. embassy in Tripoli commented at the end of 2004 that Chinese oil firms are pressing hard and many Libyans are willing to give them preference because they continued to support Libya during its isolation and U.S. sanctions. Chinese companies bid in 2005 on tenders to look for oil in Libya.

Egypt

China and Egypt have a mature relationship that dates back officially to 1956; Egypt was the first African or Arab country to recognize China. China supported Egypt during the 1956 Suez crisis and the 1967 Six Day War. The Sino-Soviet conflict occasionally complicated Egyptian ties with China. President Nasser’s criticism in 1959 of China’s military move into Tibet led to a temporary downturn in relations. In spite of brief setbacks, the relationship has been marked by frequent exchange visits at the highest levels. Egypt has consistently supported a one China policy. China recently noted that Egypt is qualified to have a seat on the U.N. Secu-

riety Council. The two countries have signed numerous agreements in a wide variety of fields and Chinese companies have constructed many projects in Egypt. Trade is significant and growing rapidly, although it heavily favors China and is a sensitive issue for the Egyptians. China is taking steps, including the offering of subsidies to Chinese traders for the purchase of Egyptian goods, to rectify the imbalance.

There are more than 85 joint ventures involving Egyptian and Chinese companies. Chinese enterprises have invested, however, only about \$56 million in Egypt. Cairo was the site in 2003 for the biggest hi-tech trade exhibition ever held by China overseas. It was designed to attract European, Arab, and African countries. Chinese companies continue to sign a wide variety of contracts in Egypt. Recent examples include \$35 million to build two ships, \$20 million for mobile phone networks, and \$922 million for twenty-two projects negotiated by companies in China's Guangdong province. China is exploring cooperation in the oil and gas sector and the two countries signed an agreement on cooperation in heavy oil technology, increasing productivity of old wells, and manufacturing equipment for the petrochemical industry. During his 2004 visit to Egypt, President Hu Jintao signed four agreements on transferring Chinese technology to Egypt, a soft loan, utilizing an economic zone northwest of the Gulf of Suez, and cooperation in the information field. The two countries have a long history of military cooperation and exchange visits. China and Egypt agreed in 2005 to create the Egyptian Chinese University in Cairo with an initial class of 900 undergraduates during the 2006–2007 academic year. This will be the first Chinese university in the Middle East. This is one more example of the mature nature of the relationship.

China, Africa, and the United States

There will inevitably be an element of competition between China and the U.S. in Africa over access to natural resources, winning of commercial tenders, and even African support for occasional different positions on political, economic, and social issues in international forums. There will be disagreements, for example, on human rights issues in certain African countries, the priority and pace of democratization and the sale of military equipment to African countries engaged in conflict. But I agree with Princeton Lyman that the U.S. should focus on those areas where American and Chinese interests converge. This should include cooperation in the reduction of disease, improving education, and assisting development generally. On the political side it means collaborating on conflict mitigation, attacking the causes of international terrorism and crime, combating African crime rings, and reducing ethnic and religious extremism that contribute to conflict and both domestic and international terrorism. It should be possible to identify courses of action towards Africa on these issues that are in the mutual interest of both China and the U.S.

Appendix

2003 Trade Between China and North, East, and the Horn of Africa in US\$

Country	Chinese Exports	Chinese Imports
Algeria	645,940,000	99,220,000
Comoro Islands	690,000	0
Djibouti	65,860,000	150,000
Egypt	937,290,000	152,820,000
Eritrea	5,740,000	0
Ethiopia	152,750,000	4,740,000
Kenya	241,710,000	8,740,000
Libya	174,740,000	40,950,000
Morocco	695,670,000	160,970,000
Somalia	3,900,000	6,620,000
Sudan	478,310,000	1,442,060,000
Tanzania	191,450,000	27,570,000
Tunisia	183,920,000	17,040,000
Uganda	51,390,000	3,500,000

Source: www.china-customs.com

Panel IV: Discussion, Questions and Answers

Cochair BARTHOLOMEW. Thank you very much. Thank you to both of our panelists. I think I'm going to take the prerogative of the Chair and ask the first round of questions, but first a sad observation that I think won't surprise either of you. It's very interesting to me that when the subject of Africa comes up, we lose four-fifths of our audience which I think is a reflection generally on the lack of attention that people are paying to the continent and what is happening there.

I had every intention of talking about national security concerns and the kinds of issues and the foreign policy objectives and places that we might be having some conflicts. But listening to you particularly, Ambassador Lyman, I was really struck because part of what else I do is work on the development agenda, and as you were talking about the sort of strings-free money that is going into a number of places and issues and concerns about corruption and transparency. We just went through a G8 meeting where some of the focus with Mr. Blair and his Commission on Africa was how to reinvigorate growth in Africa, but a major part of that has to do with transparency, good governance and accountability.

What I wonder is whether the Chinese government will participate in those activities on that front or whether we're setting up yet another situation where we are trying to do the right thing. I'm thinking also of the Millennium Challenge Corporation which is this new effort designed to make aid more effective. But if we're working side-by-side in a situation where money is flowing in without any strings attached, what does that ultimately mean for the development agenda?

Ambassador LYMAN. I think still when you look at the levels of aid and the increased levels that were talked about at the G8 meeting, African countries are still going to be heavily, heavily dependent on the flow of resources and trade opportunities, but in particular on the flow of resources coming from the Western countries and the multilateral institutions. China can't offset all of that by any means.

But I do think it's very important to reinforce the commitments that Africans have made at the G8 and elsewhere to these issues of governance transparency and to see those commitments in their own interests, and to resist the kind of alternatives like Angola seems to be playing with now.

So far I think most African countries have done that. Nigeria is doing a lot more on transparency right now and some of the other countries are, but what I think happens is you can't twist the arm in the same way with some of these countries, and I think we have to help try and bring African pressures to bear in these situations.

But also, and David Shinn and I both were talking about this, is there a way to engage the Chinese? They're not engaged on these G8 kinds of conversations about governance, etc., at all, and they take pride in not doing so.

But I wonder if one can engage them on what that means for the long-term stability of the countries in which they too have a stake? I don't know. You and the experts you call have a better sense of that than I do. But I think that may be one way to get at this question.

Cochair BARTHOLOMEW. Ambassador Shinn.

Ambassador SHINN. I would just add that in a sense China claims that it is interested in pursuing a dialogue along the lines of the kinds of things that one finds in the Millennium Challenge Account. Now I say it claims to have that interest. It does so by being very supportive, at least on paper, of the New Partnership for Africa's Development (NEPAD). NEPAD is in a sense the obverse of the Millennium Challenge Account.

Basically, it has some of the same principles it for providing aid to Africa. The difference is the Millennium Challenge Account basically says, look, you countries in Africa that are in need, you get your act together first with good governance and good economic policies, less corruption, etc., and then we the United States will provide you aid.

NEPAD, in effect, says, no, first you provide the money and then we'll get our act together. So there is an important difference here although the principles that are being acted upon are essentially the same. China claims to be supportive of NEPAD. So there may be an opening, but I'm not terribly optimistic.

Cochair BARTHOLOMEW. I'll have other questions, but I'll move on.

Cochair WESSEL. Thank you for being here. I'm trying to understand how does China and how do the Africans view our agendas on the continent in the area? Do they view us as strategic competitors, playing us off one another? Natural resources, the fight over resources, questions about governance, transparency and those issues?

Are we competing on the continent? I see China and Taiwan making fairly Taiwanese investments, going in after AGOA passed and very few American companies going in to make investments. How are we viewed and how is the agenda viewed?

Ambassador LYMAN. I think so far what the Africans see with the Chinese is a welcome alternative source of both resources and technical training as David has illustrated so well.

Also, the Chinese are willing to engage in projects that we kind of dropped out of for a long time, like physical infrastructure. We dropped out of that in the '80s and '90s. They're willing to build roads. They're willing to build dams, and that's now recognized as a very important element in development.

So I think in one way the Africans are saying, hey, this is good stuff and it's coming, and it's coming without strings, and it's meeting a need that the Westerners aren't meeting.

Second, of course, as I mentioned, the rise in prices for Africa's natural resources is a boon. Now, I don't think yet the issue of playing us off against each other has really reached a high point except in one or two cases. Obviously, Sudan is a special case. In Sudan, is a major difference between us, and Sudan has been able to use the Chinese very effectively to stop sanctions, to get military arms, et cetera, regardless of what was happening in Darfur.

And Mugabe in Zimbabwe is able to defy international opinion with the heavy investments from the Chinese. But elsewhere I think they're seen now just more as a welcome alternative or addition and I don't think the competition has reached the point where they're trying, other countries are trying to play us off too much.

But where it gets down to individual projects for American businesses who are bidding, there the competition might become very keen, like bidding for oil blocks and Chinese being able to provide sweeteners, bidding on infrastructure projects where they're willing to bid low.

That reduces the opportunities for some American companies, and I think that's something we'll have to watch very carefully.

Cochair WESSEL. Just before you go, Ambassador Shinn, before you answer, just a comment on the alternatives. Are there places where we coexist where China and the U.S. are working together and it's productive or is it an alternative strategy?

Ambassador SHINN. Places where we're working together.

Ambassador LYMAN. While you think about that, the one thing I mention—

Cochair WESSEL. To add that to the previous question, meaning please respond.

Ambassador LYMAN. Looking ahead from a business point of view, BP and China have just gone into a joint venture in Angola. So from the private sector side, I think that's beginning to happen. Sorry.

Ambassador SHINN. I may have to think about that one for a minute, but perhaps I can come back with something. Let me deal with the other aspect of the question, though, in terms of the competition. I would certainly agree with Princeton that Zimbabwe and Sudan are the two classic cases where China and the U.S. are being played off against the other, as it were, particularly in Sudan. The situation in Zimbabwe is a little different, but it's clearly a case where Mugabe has taken advantage of a situation that works very much to his advantage.

Another one that may fit into it, and it's not so much a country issue as it is a conflict issue that both members of the conflict took advantage of is Eritrean and Ethiopian border dispute and war that took place from 1998 to 2000. Both of them received significant quantities of weapons from China during the course of the war.

They received weapons from former Soviet republics and a wide number of other countries, too. It wasn't just China, and I don't even know what the dollar value is of the weaponry that went in there, but this was a time when the United States had put an embargo on weapons to both countries. China and other countries stepped in and filled that void. So there you had a situation where two countries at the same time were using China for their own interest.

On the question of oil, if you look into the future, that's a very interesting one. I think at the moment, there really isn't significant competition between the U.S. and China for African oil resources. But you have a situation today where 16 percent of American oil imports come from Africa, most of it from West Africa.

Twenty five percent of Chinese oil imports come from Africa, a combination of West Africa and Sudan. Increasingly, I think you're going to see Algeria and Libya coming into this. Sudan alone provides seven percent of all of China's imported oil. If you project into the future, the United States will be getting 25 percent of its oil

imports from Africa in ten years. I don't know what the figure is projected for China ten years from now.

But it's obviously, I assume going to be larger. The point I'm driving at here is that at some point there's going to be some more significant competition for these limited oil resources. I'll have to think a little bit more about the first part of your question.

Cochair WESSEL. Thank you. I appreciate it.

Cochair BARTHOLOMEW. Nothing jumps to mind right away. Commissioner Donnelly.

Commissioner DONNELLY. Thank you. I'm surprised to be so quick. This is great stuff. I really appreciate the Commission devoting a panel to this and I'm very pleased to listen.

I wonder if you could give me some insight into how the Chinese presence is shaping African politics per se, competition or cooperation amongst African countries, how it's affecting South Africa's ability to shape the AU into a force for progress and good governance?

In particular, with regard to these rogue regimes I think was Ambassador Shinn's turn, and I would certainly accept it, you hear reports about Chinese origin, small arms showing up in West Africa and things like that. So if you could address that general topic. Of course, it's very difficult to abstract out Western presence from this equation, but I think you see what I'm getting at.

Ambassador LYMAN. I think there are two aspects of it. One is on the trade policy, which is, of course, a big issue for us in the World Trade Organization and a big issue for African countries, particularly over agricultural subsidies and tariffs in Europe and the United States. That is going to be very big issue in this Doha Round.

To the extent that Africa can—and Africans have been reaching out to other developing countries, particularly India and Brazil, but at least on agriculture, they might have the Chinese on their side as well, and that's an important alliance for them in putting pressure on the Europeans and us to come forward on the subsidies and tariff issue.

It may block this whole Doha Round if an agreement isn't reached. So that's one area. The other is that, and I think particularly this is in the arms areas and the security area, the option of being able to go to China when there is U.N. sanctions in a situation of war and being able to find a source of arms, a country willing to ignore U.N. sanctions on the arms. As David said, they're not the only ones.

But the presence of arms in Africa, the number of small and light weapons, is a horrendous problem and it's a very great problem when the U.N. tries to come in and disarm and demobilize soldiers, and you can buy an AK-47 for ten or \$20, and there the Chinese and some of the countries of Central Europe are major players.

And that does give some of the, not only the governments, but some of the rogue elements in Africa alternatives that do cause us great problems because the conflicts have repercussions for us and, of course, we pay 25 percent of the U.N. peacekeeping budget. Of 90,000 U.N. peacekeepers in the world today, 60,000 are in Africa. So control of conflicts is a major concern.

David spoke about the Forum and I think that's an important. Ambassador SHINN. Yes, the Forum is designed for internal Chinese purposes in order to coordinate and expand its efforts in Africa, and I would argue that it's doing so quite effectively.

The other organization that I mentioned, which in and of itself is not very significant, the G77 plus China, is significant from a psychological point of view in that it tends to show the sympathies that exist between at least most of these member countries and China. This gives China a certain edge in dealing with much of the world, albeit the Southern Hemisphere, the poorer countries for the most part.

Nevertheless, 130 votes in any organization is a lot if you can corral them all. So they do have something of an advantage there. I would make a couple of other comments on how China might affect policies in Africa. If you look at the internal policies of individual African countries, I think there are some interesting things going on and not a great deal is known about them.

I have the distinct impression that there are certain countries that look rather admiringly towards some, not all Chinese policies, dealing with rural development, for example. I think if you really get down and scratch hard in Ethiopia, for example, you'll find that the rural development policy there may be taking some sheets out of the Chinese book. It's a little hard to prove that, but I would not rule that out.

There was an interesting article in the Christian Science Monitor earlier this month that suggested, and I'm not sure I agree with this, but it suggested that this knocking down of the urban areas of Harare is basically taking a leaf out of the Cultural Revolution period in China.

I'm not sure why they're dragging that up at this point, nevertheless it's interesting if there is any truth to it. If Mugabe is looking back on the Cultural Revolution and using that as an example of what one does to deal with a problem of the homeless or the dispossessed in Harare, there may be something to it.

I think more importantly, though, would be the example coming out of Ethiopia where they may be drawing upon the agricultural policies, the land resettlement policies that China has tried.

One other comment on arms to Africa. Unfortunately, this is a topic about which not very much is known in terms of getting good statistics. I don't have access to the classified materials that would be able to provide you with a really good answer.

It is clear that the level of cooperation between the militaries of China and a number of African countries is quite significant, a lot of exchange visits at the Defense Minister level, the level of generals. It's clear that they will sell arms if they find it in their interest, but trying to document that is very difficult.

Cochair BARTHOLOMEW. Commissioner Dreyer.

Cochair TEUFEL DREYER. My first question is directed to Ambassador Lyman. It was occasioned by your statement that the United States should open a dialogue with China on human rights issues in Africa. You will notice I have a certain skepticism about dialogue. It strikes me as something we say we need when we can't think of a single other thing to say as a way to solve any given problem.

I don't mean you personally; I mean this as a general statement. I wish Winston Churchill had never said, "It's either jaw, jaw or war, war." I'm annoyed with it. But anyway, that said, let's talk about a dialogue. What sorts of specific arguments should the United States raise in such a dialogue, and do you imagine that any of them might convince China to espouse a more Western style concept of human rights? From China's point of view it's probably feeling it's doing pretty well in Africa. If it should espouse an American or Western style view of human rights, what would happen? The PRC would have to stop its dealings with African kleptocracies. This would be detrimental to China's desire to create a more multi-polar world vis-à-vis the United States current hegemonic position. It would have to reduce its arms sales. What's the upside for China on this?

Ambassador LYMAN. No, I think it's a very, very important question, and the question is what would be in it for China on these things? One area is how China sees itself in the world, and here Sudan is a very good example because while I said that they have effectively blocked sanctions against the Sudanese government, they did feel enough pressure in March to abstain on the first serious resolution that said sanctions were possible in Sudan. They abstained on that resolution which also referred investigation of human rights violations in Darfur to the International Criminal Court.

They did that because there was enough international focus on what was going on in Darfur that they were looking pretty bad, and while it may not have changed them in their heart, they don't like to be seen as the standout against decency, in this case terrible deprivations. In the Security Council China very rarely exercises a veto. They either hide behind the Russians or they—

Cochair TEUFEL DREYER. They abstain.

Ambassador LYMAN. They abstain. So that's one area where you can say to them, wait a minute, where do you stand in the world?

Now, the second thing I think is going to be harder but I think is important is, no, you're not going to get them on human rights, but stability, long-term stability and supply of resources. Okay. They're interested in what we're interested economically. That is access to a steady and safe supply of oil, timber, whatever.

Instability in West Africa is a real potential if these resources aren't used well, if conflict isn't brought under control, if there isn't better governance. All you can say to the Chinese it seems to me is, look, don't undermine this. If you don't want to be out front on governance, don't be telling the Africans, whispering in their ear, that it doesn't matter because it should matter to China.

"You may be able to operate today in a place like the Democratic Republic of Congo, but you may not be able to operate if Nigeria comes apart." I think it's in self-interest arguments that you've got to come to them.

Now, I don't know whether that will appeal to them, but I think it's appealing to their interests, their sense of who they are in the world and their longer-term interests that is the only basis, I think, for that kind of dialogue.

Cochair TEUFEL DREYER. Okay. Thank you. And for Ambassador Shinn, about the G77 and China, I have a two-part question. One

is how effective do you think the PRC's courting of the G77 is or are these countries really naive enough to think that there's a high degree of coincidence between their interests and the interests of the PRC?

The second one is not really a question. It's flabbergasted amazement, and that is your statement that there were large numbers of buildings being torn down in China in the Cultural Revolution. It didn't happen. There were old signs written in old style characters dragged down from buildings and burned. There were not neighborhoods razed or buildings burned.

Ambassador SHINN. All I was doing was paraphrasing the Christian Science Monitor.

Cochair TEUFEL DREYER. Yes. If you can find me the article, I would be interested because what he says is just not true.

Ambassador SHINN. I have the article at home.

Cochair TEUFEL DREYER. Yes, I'm not disputing that you read it in the Christian Science Monitor. I'm just telling you I don't think it's accurate.

Ambassador SHINN. Okay. I'm not a Chinese expert. I'm an African expert and I certainly accept your judgment on that. It may be that the article was simply trying to draw some sort of tendentious relationship between Chinese policies and what happened in Harare.

Cochair TEUFEL DREYER. Definitely, awful things happened in the Cultural Revolution but not to neighborhoods and buildings.

Ambassador SHINN. But the article definitely linked it to the Cultural Revolution period. On the G77, the organization in and of itself is not very important. It's a debating society and they're not in total agreement on much of anything, but there is a tendency to have a point of view that supports the developing world that the West and the developed countries need to do more for it. The Chinese just slip into that kind of a forum with much greater ease than apparently the Western countries have been able to do.

But I would not for a minute want to suggest that the G77 is an important institutional organization that could really change anything because it can't. It's just indicative of the sympathy that exists among these countries, on the one hand, and China on the other.

If I could go back to your question to Princeton Lyman, I would agree that there is probably no point to have a dialogue on human rights issues. I don't think that's going to go anywhere, but the point I was trying to make earlier is that I think there is room for a dialogue on things like dealing with international crime rings in Africa, which are in the Gulf of Guinea area. This is an oil-producing area, very significant and very much of a threat to the interests of all of us, Americans, Chinese, others, The same would apply to international terrorism.

I think that it's in the interest of the Chinese as well as the U.S. to try to do what it can to prevent that from taking root in Africa and I think there are some other issues where the two countries could cooperate. But human rights, no, I don't see that as an area for dialogue.

Cochair TEUFEL DREYER. Thank you both.

Cochair BARTHOLOMEW. Thank you. I'll just interject that I suspect, although I have not read this Wall Street Journal, that the reference or the comparison to the Cultural Revolution would have been that the purported goal was that the massive transfer of sections of the population, and that, I mean they're trying to push people back out into the countryside is what Mugabe is saying.

Cochair TEUFEL DREYER. Oh.

Cochair BARTHOLOMEW. And I suspect that's where it is coming from.

Cochair TEUFEL DREYER. I see.

Cochair BARTHOLOMEW. Commissioner Robinson.

Vice Chairman ROBINSON. Thank you, gentlemen. I was wondering in terms of trying to modify Chinese behavior in places like Sudan and the more egregious of the circumstances. We haven't been entirely impressed that China has an acute sensitivity to what might be in its long-term interests. Witness the Korean Peninsula.

You'd think that they would want to take steps in using their abundant leverage to somehow get a handle on the nuclear crisis that's unfolding there and yet frankly we've looked into this at considerable length and find that not a fingernail frankly of that leverage is being applied.

So that's the kind of thing that could get a Japan to nuclearize and it should be self-evident to them that it's net destabilizing over the long term. Some of that callousness frankly is on display quite vividly in Africa. I think you'd agree.

So, if we're not going to get there on human rights for reasons that I think we understand, you both offered some very good suggestions, Ambassador Lyman and Ambassador Shinn as to ways to bring them around to the fact that we're in effect in this together and that regional stability is a positive thing and that we should all be doing something about it.

We haven't made great strides yet. I'd like to hear your reaction to one phenomena that's going on now that I think is potentially potent and interesting, namely, the divestment campaign taking place among leading U.S. universities and now state legislatures, concerning those companies that they hold in portfolio whether it's their public pension systems, in the case of states, or their endowments in the case of universities, and they are beginning to divest Chinese company stock for—notably PetroChina, but others as well—because of their perceived aiding and abetting of Sudan related genocide.

Harvard has taken this step. Stanford, Yale and Dartmouth have done so or are in the process, I'm told, of doing so. The State of Illinois has passed a law calling for the divestment of all portfolio companies, as they're referred to doing business in Sudan. New Jersey is expected to do the same.

This has that South Africa apartheid feel to it, and some would argue that it was the divestment campaign that led to the release of or was primarily responsible for the release of Nelson Mandela and ultimately regime change there. In other words, it was not a small factor. It was a large one.

The Chinese covet their position on the New York Stock Exchange where PetroChina is listed. How persuasive might this kind

of grassroots shareholder activism in the United States be if it really does sweep across the states and the university campuses as I think it might?

Ambassador LYMAN. I think it has two important implications for China. One is the one you mentioned: their continued access to capital and presence on the New York exchange market.

Second, if they're thinking about this, it is feeding in the public an anti-Chinese attitude from human rights activists, from people caring about Sudan. In terms of how their long-term relationship with the United States evolves, I don't think they want to see a growing sense in the United States public that China is a our enemy and that we really have to confront them everywhere.

So I think this is a very significant movement. And you know how sensitive the Chinese will be to it, as I said, they did abstain in March instead of stopping the resolution. They do feel some of that. So I would say something like that is a positive development. It sends a message to China that people care, that people are watching, and even though that may not hit them directly in the short-term, it may signal to them that this could be significant to them in other areas.

Cochair BARTHOLOMEW. Ambassador Shinn.

Ambassador SHINN. Yes. You have a situation where China is now getting seven percent of its oil imports from Sudan. That's obviously an important factor. It's true they did abstain on a couple of resolutions concerning Sudan, e.g., sanction resolutions.

On the other hand, during the negotiations on those resolutions, they managed to get them watered down in the Security Council, so it wasn't a complete defeat. They were, as Princeton said, sensitive to what was going on and there was negotiation. The Chinese have traditionally been reluctant to use the veto in the Security Council and they did, in fact, abstain.

I would agree with Princeton that it is an important development. It's a little different than apartheid in South Africa though because it's one step removed. In this case, it's China supporting Sudan and the policies that are abhorrent in this particular instance are what's going on in Darfur and Sudan. It's not directly aimed at China. It's indirectly aimed which makes it a little different and perhaps a little less salient than the apartheid example in South Africa.

I can remember vividly when there was all of this activity on campuses around the United States trying to get rid of apartheid. Even though there is a lot of interest in Darfur, I don't sense that it's reached anywhere near the level of the anti-apartheid movement.

Vice Chairman ROBINSON. I agree. I would just add that isn't it true that the divestment campaign, however, was directed toward companies doing business in South Africa in the same indirect fashion and hence seen as aiding and abetting that policy?

Ambassador SHINN. Okay.

Vice Chairman ROBINSON. So in that case, I do think it's quite similar and all I would say is that watch this space because I think you're going to find as evidenced again today in the so-called manhandling of Secretary Rice's staff and reporters that Sudan is going to continue to gain momentum from a divestment perspective.

Cochair BARTHOLOMEW. Thank you. Commissioner Becker.

Commissioner BECKER. Thank you, Madam Chairman. I hesitate to even say this. I spent some time in Africa quite a few years ago and it was probably one of the saddest experiences in my life really. I saw one of the sport centers that they were building in Ghana, and this was right around 1980. That was a source of absolute immense pride amongst the people there, and they loved the Chinese for what they were doing.

We were not at a competitive edge at that time and so this never entered into my equation at all in trying to judge this. But I saw the towns where the majority of the people. You have a decent town, and then you go on the outskirts, and you would have the tin and plastic and cardboard cities, as many as 35, 40,000 people living in a very, very small area. Maybe one or two water spigots, no sanitary conditions whatsoever. It was appalling, and you wonder what can be done for those kind of things. I would champion the Chinese going in and doing something. I would champion the United States going in and doing something.

The sad fact of the matter is neither one of them really do it. And this is in country after country after country. I was in a lot of them, and it was the same everywhere. The leaders—I'm making a statement—they accuse me of this all the time—and then you would think there should be a question, but there probably isn't.

The leaders were all very young, the active students in the country, or the labor movement. The leaders didn't live long and there was a constant turnover in that.

It just brought back a lot of memories just listening to what you're saying and I don't think anything changes. The Chinese can't be proud of the position they took on the Sudan. But if you go to country after country after country, they've all had genocide, the killing of one tribe against another tribe. I really don't know what you can do about the whole thing

Forgive the debt. Absolutely forgive the debt. I hate to think of us being in a competitive position with the Chinese in Africa. Because they need a lot of help; they need a lot of support, and they need everybody's help. If you have a comment on it, I'd appreciate it, but you don't have to.

Ambassador LYMAN. I do appreciate that comment. I do think what has changed and begun to change from what you report, and all of what you have said is true, is that there is a change on the continent politically. In 1980, I would guess, almost all the governments were military dictatorships. Today most of them are multi-party, democratically elected governments.

They have committed themselves to principles of better governance and democracy and human rights, although it's very uneven across the continent, but it is moving in a better direction. Their economic policies are much more realistic today than they were before, and there are some real success stories. Ghana happens to be today one of the better countries in Africa, both politically and economically, having had elections, having had the opposition replace the government party and peacefully, and the economy beginning to move. Mozambique is another.

But the poverty issues are still enormous and you know as I said, and David too, in some ways having China there building roads

and making contributions and constructing dams and good projects is not a bad thing, and in terms of all of us working together to try and address some of those poverty issues.

But because good governance is critical, because everybody agrees on that, whether it's the G8, all the meetings on Africa, you don't want the Chinese to be whispering in these countries ears, "Don't worry, don't listen to all that." That's what I would hope we don't run into because the Africans must keep moving on improving the governance side. That's critical to all the development potential that exists there.

Cochair BARTHOLOMEW. Ambassador Shinn, comments?

Ambassador SHINN. I would only add one point and I may have this statistic a little muddled, but it came out of the Gleneagles G8 meeting. I believe the figure was that 14 of the 48 countries in sub-Saharan Africa have consistently had a GDP growth rate of four percent or better. I think it was over the last five years. I may be wrong on how many years it's been. At least five years.

That means a lot of countries don't have a high GDP growth rate, but on the other hand, it does point up the unevenness of what's happening in Africa today and there is some success. There are countries that are doing well in spite of HIV/AIDS and these other problems. So I think there has been some progress since the 1980s. Since the 1980s, some countries have actually gone backwards but others have gone forward.

Cochair TEUFEL DREYER. Excuse me. Are the countries that have tended to do better the oil producing countries?

Ambassador SHINN. Not necessarily.

Cochair TEUFEL DREYER. Not necessarily.

Ambassador SHINN. You have a country like Botswana or Mauritius, which is in the Indian Ocean, that are well above four percent growth rate and they don't have oil at all. So it will not necessarily be the oil producing countries. Unfortunately, some of those countries have not managed their oil resources well.

Cochair TEUFEL DREYER. Thank you.

Cochair BARTHOLOMEW. I want to take the opportunity to thank both of you gentlemen for dedicating your life careers and your energy and your talent to addressing the challenges of the continent.

Commissioner Becker, as you know, I was in East Africa for three weeks last November. I think that one of the things that you would find quite difficult is that in the 20 or 30 years since you were there, the circumstances on the ground don't look like they've changed for a lot of people. It's about equitable distribution of wealth as well as corruption.

We know that. I think that one of the challenges is to keep the democratic governments heading in the right direction, and that is where the message that they receive both from the United States and also from China in terms of what is acceptable is going to make a difference. We're seeing this obviously with President Museveni in Uganda where he has been doing many of the right things on a number of fronts, but his own commitment to free and fair elections and yielding power seems to be questionable right now.

Commissioner Mulloy, you had a question.

Commissioner MULLOY. Thank you, Madam Chairwoman. Ambassador Lyman, I have read your testimony.

This is a question for you both. You mentioned the state-owned companies from China that will often go in there and then you quote that the fellow mentioned in Ethiopia, that he had gone in and did the low offer to achieve some kind of political objective.

That's the problem we're having in looking at the CNOOC Unocal question. I worked for Senator Proxmire, who wrote the Foreign Corrupt Practices Act. Is bribery also being used by Chinese and other companies to do commercial work?

Ambassador LYMAN. I don't have evidence of that. David Shinn had said earlier that the Chinese don't rank very highly on the Transparency International Index, so they may well feel that they can do that. They certainly aren't as transparent. You'll recall that it was only in recent years that the Europeans have agreed to do something equivalent to the Foreign Corrupt Practices Act.

China has nothing equivalent. I haven't seen evidence of that. But it may well be happening, but what they can do is complement things. Like I mentioned on Angola, they bid on the oil bloc; they also offer huge soft loans. And so they can put different kinds of resources together.

But, David, you may want to comment on that.

Ambassador SHINN. I can't provide evidence of actual bribery. As we've noted, the Transparency International Index ranking is not very good. The one thing that they do, and it's probably not illegal at all, but it's a practice that is not done usually by Western nations to provide a small quantity of free equipment, frequently telecommunications equipment since they're trying to break into the telecommunications market in key countries in Africa. The idea is to give key organizations the state monopoly on telecommunications a small quantity of equipment. Then you probably have information in advance that a big tender is going to be coming up a year or so from that date. Then you submit your bid for a tender, and you probably offer pretty good terms. You kind of grease the wheels before the deal is done, and I assume that that probably gains some business.

I certainly have heard of cases where Chinese contractors bid ridiculously low on service contracts, building a road or something like that, knowing that they'll probably lose some money on it, but never mind. If you can break into the market by getting that first project, then you're in a good shape for getting the ones that follow.

Commissioner MULLOY. Dr. Lyman, in your testimony you say we shouldn't get into kind of a race with China for influence. You said there are more areas of win/win situations. I don't know whether you enumerated those or do you have some areas that you think we should actually be approaching the Chinese on and saying these kinds of things make sense for both of us and we ought to be moving in that direction. If you don't have time to enumerate them all now, is that something that you could give to us?

Ambassador LYMAN. Yes. I'll just say we did discuss that a little bit earlier and I think you have to appeal to their self-interest in terms of stability in the areas in which they look to get resources in the future. So that would be helping control conflict, perhaps restricting some of their arms sales, and not undermining efforts at better governance because instability is against their interest as well.

David has mentioned some other areas where we might be able to find common ground.

Ambassador SHINN. I indicated earlier that international crime rings in Africa are an area that are not in the interest of either the West or China, the same with international terrorism taking root there. It's in the interest of both countries to try to prevent that. Dealing with certain conflicts is something else that I think could be lead to cooperation, not to mention working to decrease the amount of HIV/AIDS disease and improving education.

Commissioner MULLOY. Thank you both very much.

Cochair BARTHOLOMEW. Chairman Robinson, you had a quick question?

Vice Chairman ROBINSON. I was intrigued by your telecommunications example. One of the firms that has been aggressive in Africa that might jump to mind is Huawei. Does that ring a bell?

Ambassador SHINN. Yes, it does, and in the research that I did for the paper, and in fact I think I mentioned it once or twice in my paper, it came up frequently. They clearly are making an effort in North Africa. What they do is to select strategic countries like Kenya because Kenya is the communications hub for all of East Africa. If you get into Kenya, you've got the rest of East Africa. They're very smart. Let's face it; they're doing the same thing in North Africa in Algeria, which might serve as something of a hub and in Egypt. So, yes, they are very aggressive with this.

Cochair BARTHOLOMEW. I have another question. One point first, which is on the Gulf of Guinea which I think CSIS just announced that it's starting a new project on the Gulf of Guinea so hopefully there will be more focus on that.

But to get to the issue of the fight against terrorism. One of the reasons that people in the United States should be concerned about what goes on on the continent of Africa, not just for moral humanitarian and economic reasons, but that the very national security reason of failed and failing states are more likely to serve as sources of terrorism as well as dealing with issues on the poverty of despair.

Ambassador Shinn, one of the things we have seen in the past in the fight against terrorism is hard to prove, but the sense that the Chinese government has been willing in other places in order to turn a blind eye to some practices by Islamic Fundamentalist groups with the sort of general quid pro quo, that that meant that things were going to stay fairly quiet in the Xinjiang Province.

There was this sense of well, if we let things happen someplace else where we might be, then we'll be okay at home. I wonder how the fight against terrorism is going to play out in Africa, whether the Chinese government will be willing to be partners with the United States if they feel that there are benefits to them not doing it. Also if they feel that there are costs, whether they really are willing to engage on that, because particularly in West Africa and in the Horn, you know that better than I do, the potential threats to the United States and to Western Europe can be very real if we don't address some of the root issues.

Ambassador SHINN. That's an interesting point, and you obviously know a lot more about the internal situation in China than I do. I can't really relate to the issue in Xinjiang Province that you

mentioned, but I take your point. I can see where that could have an impact upon how the Chinese would deal with the issue of international terrorism elsewhere in the world.

Perhaps offsetting that, at least in certain areas of Africa, I think they would find that their interests in maintaining the flow of oil, for example, from certain countries is so significant that they don't want international terrorism disrupting that flow, I would think that might trump what is taking place internally in China.

But that's only a guess, and I don't know. You mentioned the CSIS study on the Gulf of Guinea. It actually is out. This is a copy of it, and I commend to you the two-and-a-half pages that deal with China and the Gulf of Guinea. It's quite well done.

Cochair BARTHOLOMEW. Great. We'll make sure that everybody has that. Commissioner Donnelly.

Commissioner DONNELLY. I'm just depressed because I've been trying to get AEI to do a Gulf of Guinea study for quite awhile with precious little success. I asked a multi-part question originally and one part that you didn't get around to is something I'd like to see if I could draw out.

The question whether Chinese presence has influenced relations between states and Africa in any way or in any way affected Africa's ability to organize itself sort of politically through the AU and whether like the AU's inability to really resolve the Darfur crisis or deal with Robert Mugabe is something that is affecting internal African politics?

Ambassador LYMAN. I think the way it impacts on Africa organizationally is more in the international fora. David talked to this a little bit. Take for example in the Human Rights Commission where we have tried on several occasions to get a resolution through on China. We don't get African support for that, and in return the Chinese don't press the Africans for human rights rapporteurs or commissions. It's a collaborative relationship because neither one wants outside pressure on their human rights records.

Internally, in the sense that David described about the Forum and getting Africans together around various business and development activities, there is probably some interaction and cooperation that could lead to regionalized projects in Africa in which the Chinese would be engaged. And that that may happen. But in terms of direct support to organizations like the African Union, I don't know of any, and certainly they're not helpful in encouraging the Africans in terms of dealing with Darfur or Zimbabwe.

Ambassador SHINN. The other area that is interesting and certainly merits attention is their role in African peacekeeping. I gave the figures on that earlier. It does have an impact on the inter-African relationship, at least some of these peacekeeping operations do.

Now, for the most part, they provide very small contingents of observers or specialists of some kind. They don't provide a large quantity of troops, at least they haven't traditionally. They're obviously becoming more and more interested and active in U.N. peacekeeping operations, and are showing a greater willingness to provide personnel to support them.

The last one that they offered up support for is the U.N. peacekeeping effort to ensure that the North-South peace process goes

forward in Sudan. The Chinese have volunteered to provide some kind of personnel for that effort. That's a fairly significant development. This whole involvement in African peacekeeping is quite new and important in terms of what they're trying to accomplish.

Commissioner DONNELLY. If I could follow up just on that front. What is the effect of getting the Chinese involved in the North-South resolution? Maybe they do have a humanitarian interest there, but if it serves to divert attention or to reinforce the legitimacy or the position of the regime in Khartoum, in other words, there could be sort of nefarious interpretation of that and a positive one.

Ambassador SHINN. Yes, my guess is their interest is very much their self-interest here. The oil in Sudan is located largely in the south or along the north-south border area and there are large quantities of undeveloped oil that are deep in the south, and I think that this is a way for the Chinese to have a foot in the door to monitor what's going on with the oil.

Now, as it happened, both the North and the South are all agreed upon this for the moment. So this is a win/win situation for everyone concerned, and there is nothing that China loses in this kind of an operation if they're invited in. They may have a more nefarious goal in mind here, but I really see it as just a way to be on the ground to know what's happening in the South and how it might impact their additional future oil interest there.

Cochair BARTHOLOMEW. A couple of closing comments before thanking you. I think it would be interesting to get a graduate student tracking. Ambassador Lyman, you mentioned the U.N. Human Rights Commission.

One of the complaints we've always had about the U.S. Government is it waits until about a week before the U.N. Human Rights Commission is supposed to take up the resolution to decide whether they are even going to do something, whereas we also know that the Chinese government essentially approaches the countries that have been named to the Human Rights Commission the day after they get named, and the day after the resolution has been resolved one way or another and start doing it. So it would be very interesting to track assistance flows into some of those countries.

The second thing is that a lot of what goes on with the Chinese government in Africa is out-negotiating Taiwan. There are a number of countries that have benefited quite significantly from competitive aid packages from first one place and then the other. So it's part of the checkerboard that takes place or the chess game that is taking place in terms of Taiwan.

Commissioner Wessel has another question.

Cochair WESSEL. Very quick. I raised the issue earlier of AGOA. And I've seen some preliminary data that it had indicated in the initial stages that there was more Chinese and, in fact, Taiwanese investment than U.S. investment, and that AGOA was used more as an investment platform for those interests coming here and not necessarily assisting in as robust development as we would hope, I guess, in the region.

Can you comment on that in terms of the success and the investment patterns?

Ambassador LYMAN. AGOA did produce in its first few years significant increases in African exports, and I'm excluding now oil which also has been counted, but oil would have come in anyway. For the smaller countries like Lesotho and Swaziland and Mauritius, textiles were extremely important, and employment in places like Lesotho was in the tens of thousands of people who were now newly employed. Most of the investment in those textile industries came from Asia. That's absolutely true.

What's happened, however, with the end of the Multi-Fiber Agreement is that the Africans can't compete as well in the American market against Chinese exports. So we've seen now a decline in AGOA.

Cochair WESSEL. The Chinese—the Africans.

Ambassador LYMAN. Africans can't compete in the U.S. market. So even though they have duty-free entry, the amount of AGOA exports in textiles has begun to go down. It's another complaint they have with the Chinese and that investment is beginning to pull back. So if you notice, Secretary Rice at the AGOA meeting in Dakar just the other day was offering funds to help the Africans diversify out of textiles, sort of saying maybe you can't compete.

But AGOA initially had some very positive effects in a number of countries and still has, but now they're going to find other exports.

Ambassador SHINN. I would only add that in the written paper that I presented, and under the section on Kenya, it has become a really serious problem there. You have a situation where some six textile factories have shut down in Kenya because of the changes caused by the Multi-Fiber Agreement, and it's caused a lot of angst among Kenyans in the textile industry. They refer to it as the "Chinese tsunami" disrupting their efforts to export textiles. Tunisia has also had a problem with this and other countries around the continent too. So it is a problem.

Cochair WESSEL. But it was originally, most of it was, in fact, Chinese or Taiwanese investments.

Ambassador SHINN. That's correct.

Cochair WESSEL. So the tsunami is somewhat—

Ambassador SHINN. And now that's pulling back. It's pulling back to some considerable extent.

Cochair WESSEL. Right. Thank you.

Chairman D'AMATO. Thank you. And so that we end on a positive note because I think everybody is feeling a little discouraged here, it is true, as you gentlemen know better than we, that there are a number of leaders in Africa and a number of civil society organizations that are really pushing forward with the goal of educating their population, of providing health care and of moving economic growth forward.

So I think for countries that are being clever about this, there are ways to harness the interests both of the United States and of the Chinese government in helping them move forward.

Thank you very much.

Ambassador SHINN. Thank you.

[Whereupon, a short break was taken.]

PANEL V: CHINA'S APPROACH TO LATIN AMERICA

Chairman D'AMATO. The Commission will resume. Now our tour de force of the world arrives at Latin America. We have with us three experts. From left to right, Dr. Claudio Loser.

Mr. LOSER. No.

Chairman D'AMATO. Loser. I'm sorry.

Mr. LOSER. I've heard it before?

Chairman D'AMATO. Have you? We can change it right here.

Mr. LOSER. Not your fault.

Chairman D'AMATO. Senior Fellow with the Inter-American Dialogue, focuses extensively on Latin American economic issues. Mr. Loser has served at the International Monetary Fund where he was Director of the Western Hemisphere Department. Much of his recent attention has been on China's rising economic presence in Latin America.

And Dr. Cynthia Watson, Professor at the National War College where she focuses on a wide variety of topics. She's written extensively on nuclear developments and civil military relations in the Third World especially involving China.

Dr. Watson's 2003–2004 sabbatical project examined the competition between China and Taiwan for access to South America with an emphasis on military relations.

And third we have Mr. Al Santoli, President and founder of the Asia America Initiative. Prior to this position, Mr. Santoli had been Senior Vice President of the American Foreign Policy Council and a former editor of the China Reform Monitor. He has also worked as a foreign policy and national security advisor to the House of Representatives.

Welcome all three of you, and our standard procedure is to go from left to right, and if you would summarize your written materials, they'll be placed in the record as written, summarize them in seven minutes or so, and then we'll go to Q&A. Mr. Loser.

**STATEMENT OF CLAUDIO M. LOSER
SENIOR FELLOW, INTER-AMERICAN DIALOGUE**

Mr. LOSER. Thank you very much. Before beginning with my presentation, I want to thank the government of China for reducing the pressure I felt by appreciating their currency by two percent this morning. So this helps a little bit in terms of what I think the trends in economic performance for the country and for the rest of the world is.

Now, I'm sure you have heard about all the important facts on China itself. I'm just going to make a presentation of a few charts that might be of interest. First is this chart showing the level of foreign trade in China starting in 1970 compared to the rest of the world. You, of course, know about the very rapid rate of growth, and China being close to becoming the second largest trading country in the world.

Going directly to Latin America, let me show you first what we see in terms of the growth of trade in U.S. dollar terms. What we see is that from 1990 trade, the sum of imports and exports was about \$2 billion. Now, it is close to \$40 billion estimated, a large number.

Now, GDP for Latin America is about \$2 trillion, and to give it the right perspective, the level of remittances that Latin America

receives from the developed world, U.S., Canada and Europe, today is about 40 to \$50 billion. So trade with China, if you look at exports, is about half as important as remittances are for Latin America.

Now, according to what I can see, China did not have a major interest in Latin America except for the conflict with Taiwan where there are still 12 countries in Latin America that recognize Taiwan as a representing China. However, Latin America has become truly a very important region for China, particularly as a market and as a source of food and raw materials.

Now, trade has increased very significantly. The major trading partners for China in Latin America are Brazil, Mexico, Chile, Argentina and Panama, which are really account for the bulk of trade. In addition, the Andean Community which is the area of Bolivia, Peru, Ecuador, Colombia and Venezuela, become sort of the fifth partner.

In order to see the importance of China in the trade of Latin America, I want to show two things. First, how in this chart what you see is exports and imports for the countries in Latin America; how is China ranked as a trading partner?

For Brazil in 1998, it was 13th. For 2003, it was the third largest destination of Brazilian exports. In the case of Argentina, it moved from eight to four, and in the case of Mexico, from 31 to six. In terms of imports, again, in Brazil it became the fifth largest trading partner. Mexico, it's really the second. In Chile the fourth. So you can see that it has become much, much more important.

However, if we look in this new chart at the importance of China, it is from top to bottom the third green square. What you can see is that it was virtually insignificant. It was about .7 percent of total trade, total exports of Latin America in 1990. Today it's three percent, and really in today's world, the United States constitutes about 48 percent of Latin American trade. The intra-Latin American trade is 16 percent. The European Union is 14 percent.

I know these numbers may sound a bit boring, but fundamentally it shows that China is really relatively small. Now, actually you have to divide Latin America in two groups of countries in order to see what the importance of China is.

South America basically is an exporter of goods to China. Central America, the Caribbean and Mexico are the competitors. I was hearing about the last presentation, Africa, how there were problems about competing in the textile side after the Multi-Fiber Agreement finished, and fundamentally you have the same issue in Latin America, only that you may have a somewhat more sophisticated industrial base.

But fundamentally, you have that the north is "suffering" from Chinese competition. The south, Argentina, Brazil, Chile, Peru, even Venezuela to a lesser extent, are exporting. It is soybeans, it is copper, it is steel, it is a number of raw materials, and basically are the boom business of the year or the last few years for the Latin Americans.

The interesting thing is that still for China, Latin America represents a very small proportion of total trade. China, only 2.6 percent of its trade is with Latin America and the Caribbean. The U.S. has 21 percent.

In terms of imports, it's a bit more for China, a bit less for the United States, but it shows again that the size is not that large. Let me give you another interesting chart. This is the share of U.S. imports from Mexico and from China. Mexico was growing very fast in the last few years, and I only had the information through 2003 complete from the IMF. It shows that Mexico has become second to China in terms of a source of imports, and it has a lot to do with the capacity of the country to compete.

Now, in terms of how this reflects in the balance of trade, meaning the difference between exports and imports, what we see in this final chart is the top line is Brazil, and this shows the net exports of the country, and it shows Brazil is having a very positive position. So does Argentina and Chile. Mexico, on the other hand, and Panama are net importers, so we cannot talk about one single story.

Very briefly, let's discuss investment. China is investing. It has promised a lot of investment in Latin America. Not much has taken place. There were plans for \$8 billion in investments in Brazil. The Argentines were dreaming about \$20 billion in investments over the medium term. I'm saying dreaming because nothing has materialized after the visit of the president of China to the region at the end of last year.

And although China invests a lot in Latin America, it represents only a small fraction of total foreign investment in the region—mostly in infrastructure and in petroleum and related industries.

Fundamentally, from an economic point of view, China is a very dynamic new presence, but still it's a very small and Latin America for China is an unknown market. They really don't know too much about the region, and I always make a parallel between China and Japan.

Japan also got into Latin America heavily and got burned, if I can use the words freely, and now have withdrawn from Latin America, and China is moving slowly because there are differences in terms of how the two areas operate and basically China, in terms of trade and investment is operating more in the U.S. and in East Asia. That's where I stop.

Thank you.

[The statement follows:]

**Prepared Statement of Claudio M. Loser
Senior Fellow, Inter-American Dialogue**

China's Rising Economic Presence in Latin America

China's Economic Performance

China has experienced almost 8 percent average annual GDP growth rate in the past two decades. China's trade volume totaled US\$1,154 billion in 2004, reflecting an 18 percent of annual trade growth rate (Figure 1). Now, China's trade volume accounts for more than 6 percent of world trade. In particular, China's accession to the World Trade Organization (WTO) in 2001 has caused external trade to surge. In 2004 China overtook Japan, becoming the world's third largest trading country, behind only the United States and Germany. China's emergence in the world market has significant implications for the global economy as well as for all Latin American economies. (This paper is based to a large extent on the paper by the same title, written by T. Funakushi with Claudio M. Loser, issued earlier this month by the Inter-American Dialogue).

China's Increasing Influence in Latin America

Latin American economic relations with China traditionally had not been strong. China and Latin America do not have significant political interests in common, ex-

cept for Taiwan. Some Latin American countries still recognize Taiwan. Due to the potential long-term advantages of developing economic relations with China, Dominica and Grenada switched their allegiances in 2004. China seeks to expand its influence by persuading Central America, Panama, Paraguay, and some Caribbean countries to break diplomatic relations with Taiwan. Recently, however, Latin America has been at the center of attention of China. Latin American countries offer large markets for China's manufacturing export products. Moreover, China's market is very attractive to Latin America. The rising demand from China, especially for agricultural products, raw materials and energy, partly accounts for recent Latin American economic growth.

Trade between China and Latin America has increased dramatically, especially since 2000 (Figure 2). Trade volume grew from US\$200 million in 1975, to \$2.8 billion in 1988, and to some \$40 billion by 2004, rising by 54 percent compared to the previous year. China's exports reached \$18 billion and imports nearly \$22 billion.

In Latin America, Brazil, Mexico, Chile, Argentina and Panama are China's top five trading partners. Brazil totaled US\$8 billion in 2003, followed by Mexico at \$5 billion, Chile at \$3.5 billion, Argentina at \$3.2 billion, and Panama at \$1.5 billion. The Andean Community countries as a whole amounted to \$2.6 billion in 2003.

China's share in Latin American exports expanded from 0.7 percent in 1990 to 2.9 percent in 2003, and its share in Latin American imports grew from 0.5 percent to 4.8 percent during the same period. Table 1 shows China's growing presence as a trading partner in major Latin American countries.

In 2003, the United States accounted for 48 percent of Latin American total trade, followed by intra-regional Latin American trade at 16 percent and European Union (EU) trade at 13.8 percent (Figure 3). Although China has gained greater influence in Latin America over the last decade, China constituted only 3.9 percent of Latin American total trade. The share of exports to Latin America in China's total exports increased from 1.6 percent to 2.6 percent, and the share of imports from Latin America in China's total imports grew from 2.4 percent to 3.6 percent (Table 2).

China's Trade Relations with Latin America

While most of Latin America's economies are far better managed today than they have been in the past, the region as a whole has fallen behind the rest of the world. Over the past 50 years, economic growth in Latin America has lagged that of most other developing regions. More specifically, in 1994, China's economy was one-third the size of Latin America's; today, they are about the same size. China is exporting more, saving more, investing more in education, and securing far more foreign investment. It has to be noted, however, that China suffers from many inefficiencies, including high levels of corruption, complex regulation, poor accounting standards, ineffective bankruptcy procedures, heavy government intervention, and an unsound banking system, areas where Latin America has made considerable progress over the last 15 years. (This has been described in "A Break in the Clouds: Latin America and the Caribbean in 2005," Inter-American Dialogue Policy Report, July 2005).

The accelerated growth of China (and India) is having a mixed impact on Latin America's economies. For Southern Cone countries such as Brazil, Chile, and Argentina—as well as other resource-rich nations such as Venezuela—the rapidly expanding Chinese market for foodstuffs and minerals has produced sharply increased export revenues. These countries are also looking to China as a potential source of new investment. Other countries, such as the Central American republics and Mexico, view China largely as a competitor, a low-cost producer of manufactured goods, which is cutting into their markets. With this year's expiration of worldwide textile quotas, China has emerged as an even stronger commercial rival. The longer term challenge for Latin America, however, is China's rapid technological advance, given the comparative quality of Chinese schooling, the country's commitment to build its science and engineering capacity, and its access to international capital.

On the export side, China's recent export surge has been largely attributed to the manufacturing sector that accounts for more than 90 percent of China's total exports. Some of the fastest growing sectors include toys, textiles and apparel, and electronic machinery. China poses the greatest threat to countries that rely heavily on labor-intensive manufacturing as their export advantage, particularly in Central America and Mexico. In recent years, the manufacturing sectors of such countries have suffered the effect of Chinese competition, especially in the U.S. market (Figure 5). The year 2003 also marked the first year in the post-NAFTA era in which Mexico lost market share in the U.S. import market. More than 250,000 Mexicans in the *maquila* sectors lost their jobs during 2001–2003. Some 300 *maquiladoras* moved from Mexico to China.

The direct competition in the textile and clothing sectors between China (and other emerging countries like India) and Latin America in world markets has inten-

sified since the Multi-Fiber Agreement (MFA) quotas on textile and apparel were phased out in January 2005. In 2003, China and Latin America (Mexico 10 percent and other 16 percent) each accounted for one-quarter of the U.S. clothing market. In the post MFA era, China and India share may double and that of Latin America may fall by two-thirds.

Most Latin American countries are losing their shares in the U.S. textile and clothing markets. The proximity to the United States and lower transportation costs should be an important source of comparative advantage, especially for Mexico and Central America. However, this hardly compensates for the advantage of Chinese costs both in labor and fabrics. Labor costs in China are about one-third of those in Mexico. Given these conditions, textile and clothing exporters in Mexico, Central America and Caribbean countries are unable to compete against Chinese and other Asian manufacturers in spite of preferential agreements.

On the import side, there has been a rapid growth in imports of raw materials and mineral fuels. China, though a major crude oil producer, became a net importer in 1996. In addition, China's imports of agricultural products have been increasing. Although China is a large producer of agricultural products in the world, it became a net importer of agricultural products in 2003. China is importing more energy and raw materials from Chile, Andean countries and Brazil; and is also importing more agricultural products mainly from Brazil, Argentina, Chile and Uruguay. Argentina and Brazil now stand as China's second and third largest agricultural product suppliers respectively. Hence, these countries are likely to benefit from China's economic growth. In particular, China's imports of soybeans from Brazil and Argentina, iron ore from Brazil, and copper from Chile and Peru are significant, and are helping their exports to boom.

Chinese Investment in Latin America

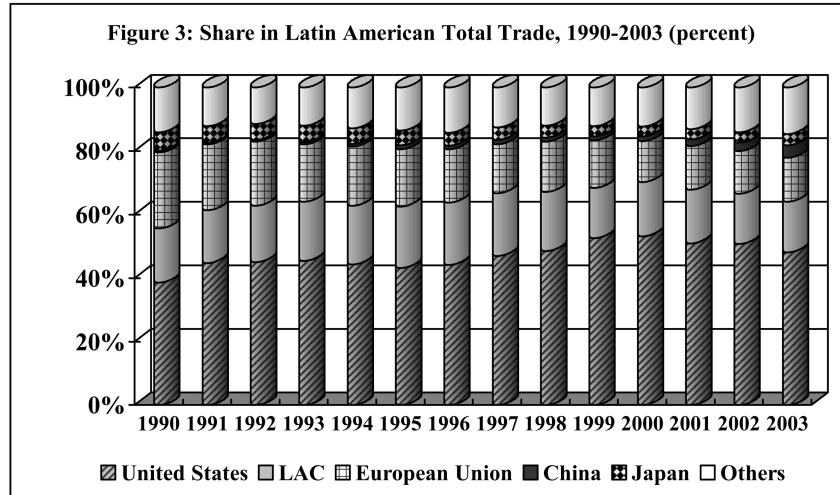
While China's trade volume has increased rapidly, both globally and in Latin America, Chinese investment abroad has not been significant. According to the *China Foreign Economic Statistical Yearbook*, China's cumulative foreign direct investment (FDI) worldwide amounted to US\$33.4 billion at the end of 2003, which made up for only 0.5 percent of global FDI stock. China has been actively seeking investment opportunities in Latin America to secure supplies of needed inputs. Latin America accounted for 46 percent of China's total FDI destinations in 2004. Chinese President Hu Jintao stated that China would invest \$100 billion in Latin America over the next decade, during his visit to several Latin American countries in November 2004.

Chinese investments have been concentrated in the petroleum and mining sectors, mostly in Peru, Chile, Venezuela and Brazil, as well as in the manufacturing sector in Mexico. China's relations with Brazil are the most extensive of any Latin American country, including cooperation in areas such as mineral exploration, aerospace, technology science, satellite and nuclear energy. China is offering an investment of about \$8.5 billion in port and railway, oil, steel, and aviation projects in Brazil. China promised to invest heavily in Venezuela's oil and gas sectors, to help secure its access to fuels. China also promised Argentina in broad terms \$20 billion of investment in railways, oil and gas exploration and construction projects in the next 10 years. Moreover, China intends to invest in the Bolivian gas, Ecuadorian oil, Colombian oil and coffee sectors, as well as in the expansion of the Panama Canal, where Chinese ships are now the second largest users after the United States.

Nonetheless, there are concerns over Chinese investment in Latin American countries. The pace of new investments is slow and many plans do not materialize due to the continued presence of political and institutional risks. China has little experience in investments abroad and lacks information about business climate. The Chinese government may offer a tied loan for its political objectives and control over investments abroad, and furthermore it may become disillusioned about the region, as Japan did in the past.

Trade between China and Latin America will continue to grow at a rapid pace over the coming years. Despite that, China's share in Latin American trade will remain relatively small, compared to the share of the United States and European Union. Taking into account China's economic bottlenecks and uncertain investment promises, Latin America probably cannot rely on China, as the source of trade expansion. With solid macroeconomic management, most Latin American nations are well positioned to compete with China and other global rivals. To succeed, however, they need to make their economies more productive and less volatile, and further integrate them into the world economy.





Source: IMF Direction of Trade Statistics

Table 1: China's Presence in Major Latin American Trading Partners in 1998 and 2003

Country	Exports				Country	Imports			
	1998		2003			1998		2003	
	Ranking	Share	Ranking	Share		Ranking	Share	Ranking	Share
Brazil	13	1.8%	3	6.2%	Brazil	12	1.8%	5	4.4%
Mexico	31	0.1%	6	0.6%	Mexico	6	1.5%	2	5.5%
Chile	9	2.9%	3	8.6%	Chile	7	3.8%	4	6.6%
Argentina	8	2.5%	4	8.4%	Argentina	8	3.6%	4	5.2%
Peru	4	4.1%	3	7.7%	Peru	19	1.3%	6	3.5%
Panama	19	0.7%	19	1.2%	Panama	24	0.4%	3	9.0%

Source: IMF Direction of Trade Statistics

Table 2: Share of Trade with Latin America as a Percentage of Total Trade, 1990-2003, (percent)

	1990	1992	1994	1996	1998	2000	2001	2002	2003
Share of Exports to LAC as a Percentage of Total Exports (percent)									
US	13.7	16.9	18.1	17.6	20.9	21.7	21.8	21.5	20.6
EU	1.8	2.2	2.5	2.5	2.6	2.4	2.4	2.1	1.8
China	1.0	1.0	1.9	2.0	2.8	2.8	3.0	2.8	2.6
Japan	3.4	4.4	4.4	4.1	5.0	3.9	4.1	3.6	3.6
Share of Imports from LAC as a Percentage of Total Imports (percent)									
US	13.0	13.0	13.3	15.4	15.9	17.0	17.3	17.5	17.1
EU	2.4	2.2	2.3	2.1	2.0	2.1	2.1	2.1	2.1
China	2.4	2.1	1.8	2.5	2.1	2.1	2.7	2.8	3.6
Japan	4.0	3.5	3.3	3.2	3.2	2.8	2.6	2.6	2.5

Source: IMF Direction of Trade Statistics

Cochair BARTHOLOMEW. Dr. Watson.

**STATEMENT OF CYNTHIA A. WATSON
PROFESSOR, NATIONAL WAR COLLEGE**

Dr. WATSON. I'd like to take this opportunity to thank the Commission for the opportunity to speak. Since you have my entire statement, I don't see any point in repeating it. But I do want to make a couple of points that flesh out a little bit what I've said. The first thing that I would say is that I agree entirely with what Mr. Loser said, that Latin America is not nearly as significant for China as some people have wanted to assume.

I think it's very seductive to assume as a result of interest in Venezuela and petroleum in particular, that the region is escalating at a very rapid pace in terms of the priorities. I would put Latin America as the fourth priority of China around the world, certainly no higher than that.

That doesn't mean that in the future, they can't rise. I guess my first significant point would be that Latin America is a place where China is building relations for the future. I don't think at this point—

Mr. LOSER. Sorry.

Dr. WATSON. People laugh at me all the time. I'm used to it. That's okay. No, it's always entertaining to go behind an economist that people are laughing at. So it's okay. I can handle it.

Mr. LOSER. Thank you very much.

Dr. WATSON. I've spent a lot of time in Argentina. I understand this. The Chinese don't need to have Latin America as a major priority right now. It's not in their interest as they assess it to raise concerns in Washington, and by taking steps that put Latin America out front center, then I think that they are afraid they will raise those concerns, and I think they are accurate. I think the fact that this Commission and other committees on the Hill have not raised questions about China's involvement in Latin America until this point when we can take the data that shows that their interests have been growing, certainly over the last five years at a fairly rapid clip, if not even longer, is indicative of the fact that they have moved very judiciously.

The second thing is that China is moving into Latin America is not just the fact that for them economic growth is a national security issue. It's the national security of the Communist Party staying in power if they have the assets that they need to continue their economic growth.

At the same time, I think we have to be realistic that Latin America's perception of the relationship with the United States is that there's a vacuum there. I think Latin America is opening its arms to China and China is reciprocating. But we would be naive if we didn't recognize the fact that as the United States is fully engaged in at least two other parts of the world that we're all very familiar with, this has led to a perception within Latin America that we are no longer interested in the region.

This Administration has done a better job than several prior Administrations at trying to indicate the Administration's concerns about the region. But Latin America perhaps had unrealistic expectations going in.

They really believed that President Bush with his Texas experience, with his brother being a governor in a state with very close ties to Latin America, I think they expected nirvana, shall we say, and it wasn't going to happen under any set of circumstances, but what that means is that our role in this part of the world impacts upon China's ability as well as its willingness to engage.

The third thing that I think bears remembering, but all too often gets ignored, is right now there is so much emphasis on the bilateral relationship between Venezuela and Beijing, that is I think an anomaly. The statistics that Mr. Loser showed and other statistics across the board show that the real potential for Chinese interests in this region, that I think has a strategic implication for us is with Brazil, and it is with Brazil on a range of things.

He mentioned foodstuffs. Most people in the United States don't realize the percentage of soybeans that come out of Brazil. People in the United States don't recognize the other foodstuffs that come out of Brazil and the rest of the region. As Beijing is trying to alter its domestic economic situation and to move from being an agricultural based society, you've got to find a way to feed people, and if you can buy those foodstuffs instead of investing in very inefficient agricultural sectors at home, all the better, and therefore I think it's important to focus on Brazil, first for foods, as well as for technological advances and for some joint ventures that have largely been lost in the fact that the current president of Venezuela is considerably more flamboyant than the president of Brazil, although that may be changing in Brazil right now. But I think that that's an important thing that has to be thought about for the long term. Let me stop at that point.

[The statement follows:]

**Prepared Statement of Cynthia A. Watson
Professor, National War College**

Mr. Chairman and Members of the Subcommittee: I welcome this opportunity to share the results of my research on blossoming links between the People's Republic of China and Latin America. This study coincides with concerns about improving Chinese economic, diplomatic, and military capabilities around the world at the same time that U.S. ties with its neighbors in the hemisphere are fraying. This discussion comes as other commentators review the implications of China's CNOOC bidding for a U.S. petroleum firm, something unthinkable only a few years ago. While I do not believe that Chinese involvement currently indicates a serious threat to the security of the United States, I believe that Beijing seeks to establish networks which will benefit its interests for the long term, possibly to the detriment of U.S. security.

The recent spate of press reports on China's growing energy and natural resource consumption is an initial explanation for Beijing's growing interest in South America. While the continent remains at least *fourth* on China's list of priorities, the vast array of natural resources available, coupled with a growing population eager to increase its consumption of goods, makes Latin America ever more enticing. The PRC seeks to put a modest investment in diplomatic, military, cultural, and trade relations for a possible long-term gain of significant proportion.

Beijing has expanded its role in South America since 1970 when states in the region moved towards it diplomatically. The six nations of Central America, with their small populations and predominantly agricultural-export economies, retain diplomatic recognition of Taiwan (Republic of China). Prior to 1970, only Cuba maintained diplomatic ties—and ideological solidarity—with the PRC, after Castro transferred his allegiance in 1960. Beginning with Chile in 1970, however, all but one South American state have moved to recognize Beijing as the capital of China instead of Taipei. Paraguay has been the sole outpost for Taiwan since Uruguay finally abandoned Taipei in favor of Beijing in 1988.

For much of the past thirty years, China's ties with South American states have come in fourth place, behind growing interests in bilateral relations with the Pacific Rim (especially United States and Southeast Asia), European, and African states. The last of these is a region with which China could project "Third World solidarity" and considerable influence in the absence of competitors. Trade with South America has grown slowly, because Beijing's interests have been elsewhere until recently (so much of its focus was on events within rather than ties with other regions so distant). At the same time, the region has been absorbed first, with the trauma of the "external debt crisis" (1980–1989) and then the giddiness, followed by profound disappointment, of the "marketization-democratization" processes of the 1990s. Along with these processes were the implied expectations that Washington, absolved of the Cold War requirements, would finally turn its attention to the long-desired partnerships with states in its own hemisphere. The 1990 "Free Trade Zone of the Americas" proposal by the first President Bush, followed by the ratification of the North American Free Trade Agreement (NAFTA) and 1994 Miami Summit commitment to finalise a free trade pact for the entire region, were initial indications that Washington would finally carry out its word. Instead, the 1990s turned into a period of severe disappointment as free markets led to rampant corruption and unfulfilled expectations in Latin America while Washington became the world's superpower rather than a partner for the region. In short, neither side of the western hemisphere had a pressing reason to raise the other in its list of priority relationships. The current move towards the Central American Free Trade Agreement (CAFTA), not obviously destined for passage, is an extension of this pattern in Latin American eyes.

The Last Five Years of Deepening Ties

U.S. analysts were startled when PRC President Jiang Zemin embarked on a tour of South America as the EP-3 incident unfolded in early April 2001. A constant stream of senior People's Liberation Army (PLA) officers and PRC political leaders had been arriving in various South American capitals for many years. (Indeed, Latin American military officers had long been welcomed to the PLA's National Defense University foreign course for professional military education when officers from the "western world" were not welcome to Beijing.) Jiang's willingness to be out of the country at a time of such sensitive negotiations with Washington indicated not only his confidence in the political and diplomatic leadership left behind in Beijing, but the importance he attached to China's relations with South America. The trip to Chile, Argentina, Brazil, Venezuela and Cuba sent that message to these states. A string of meetings between senior officials from the region and the PRC followed Jiang's 2001 visit. Defense Minister General Chi Haotian held talks with Colombian and Venezuelan defense authorities and National People's Congress head Li Peng spent significant time in Uruguay, Argentina, and Cuba during a three-week trip abroad. A host of South American military and political leaders regularly make their way to the PRC for talks on trade, investment, military exchanges, and political ties.

In November 2004, both Presidents Hu Jintao and George W. Bush visited the region in conjunction with the APEC summit in Santiago. What was most noteworthy about these visits was Chinese President Hu Jintao's visit to four Latin American countries rather than the summit itself. While President Hu met with President George W. Bush for fifty minutes in one of the first foreign discussions the latter has had since his reelection victory, the meeting was anticlimactic compared with the interest that Hu's tour generated in the region. Hu's was not the first visit by a Chinese President but China remains an exotic place in the Latin American mind. The historical connections which China has long had with Africa, for example, have not existed with Latin America even though the majority of regional states shifted diplomatic recognition from Taipei to Beijing as early as 1970. The ties between Beijing and Latin American states have remained relatively low-keyed. Latin America, particularly Brazil, has had a history of some Chinese immigration but at a miniscule level compared with that of Italy, Germany or other European states. Latin America just hasn't had China much on its mind.

Two fundamental shifts, one on each side of the Pacific, have made this infatuation with Hu and China possible. On the Chinese side, energy requirements have grown, along with Beijing's increasing global presence and confidence. Beijing routinely has major delegations visiting states around the world.

Hu's visit to Latin America was seen in China as an event in conjunction with a major world meeting of interest to the People's Republic and its rightful role in the world. Fear of a negative U.S. reaction was not a concern; the trip through Brazil, Argentina, Chile and even Cuba attracted little attention in the United States, generating some curiosity on the part of regional specialists, but not the sus-

tained concern one might have expected if U.S. attention was not consumed by events in southwest Asia and the Middle East.

For Latin America, long impatience with U.S. neglect translated into virtual giddiness at the Chinese leader's appearance in the region. The contrast between President Hu's triumphant week-long tour of the region contrasted starkly with President George W. Bush's limited time in Santiago, followed by four hours on an island off the Colombian coast. Additionally, the protesters who filled Santiago's streets indicated that the U.S. President's message was not welcome in Latin America. Ironically, Hu Jintao's vision of greater economic, financial, trade, and technology ties was precisely the sort of engagement that Latin America has long wanted from Washington.

Latin America was ready to welcome someone who came with a smile and an outstretched hand, rather than the lecture and wagging finger Latins have received from so many high level U.S. visits. While Latin American sky-high expectations of enhanced ties with Beijing are probably exaggerated and likely to lead to disillusionment, the partner in this case is fresh and hence likely to be forgiven if it does not come through immediately. After all, Latin America has awaited Washington's attention for generations. Surely, some will argue, China merits some time to get serious about its long-term interest in greater economic and political interaction with Latin America.

In December 2004, Venezuelan President Hugo Chávez Frías made a trip to China where he was feted and discussions of long-term Chinese-Venezuelan relations got ink since Chávez Frías has made clear his intention to deemphasize—but not break—relations with Washington for the sake of meeting his core constituency's concerns about Venezuela being exploited by the United States. Chávez Frías and the Chinese leadership signed a number of agreements, largely in the energy field, to boost Beijing's role in the South American state. In this particular instance, China seeks to better its position on *orimulsión*, a type of power plant fuel in which the Venezuelans excel at production and export.

Unreasonable Expectations and Clashing Goals

Beijing will not fully meet the expectations of Latin Americans because the leadership appears to be calibrating carefully its involvement in the region. Hu visited Fidel Castro's Havana but it was a low-key affair concentrating on possible biotechnology sharing between the two regimes. This did not even attract much attention. That Hu did not include oil-rich but politically unstable Venezuela on his itinerary is a key indicator. In 2001, Jiang Zemin stopped in Caracas on his extended tour of the region. That preceded the 2002 coup attempt where Washington appeared to be on the wrong side (supporting the coupmeisters) and has led to a terrible state of affairs between Caracas and Washington. While Hu would like to solidify ties with Venezuela to increase the access to petroleum supplies, he delicately avoided that stop. By meeting with President Hugo Chávez Frías, the Chinese would have attracted much more attention and potentially negative consequences. Additionally, Hu chose not to visit Colombia where there are many resources, including petroleum that interest Beijing, but President Bush has his strongest regional ally in Alvaro Uribe Vélez.

Despite seven decades of attempting to industrialize their economies, South American states still depend almost entirely on exporting raw materials and light processed goods. Brazil is the exception, having worked assiduously over the past twenty years to develop an autonomous space program, with an equatorial launch site that appeals strongly to Beijing. Petroleum leads the list of resources South American states have to offer the PRC. Despite the erratic nature of its current government, led by the virulently anti-U.S. President Hugo Chávez Frías, Venezuela is an important source of energy to China. Beijing has invested over \$1 billion in the nation and seeks to maintain good, even warm, relations with Caracas, primarily to take advantage of the aforementioned *orimulsión*. Beijing has such rising energy needs that it is willing to overlook Chávez Frías' eccentricities (which are not aimed at him at present) to take advantage of poor U.S.-Venezuelan ties. China also seeks to buy petroleum elsewhere in Latin America, which may contain as much as 14% of the recoverable petroleum deposits in the world.

Ecuador is another particular target of PRC petroleum interests, who hope to sign exploration agreements which will lead to a "strategic alliance" between the two states. China has also shown interest in projects in Argentina, Colombia, and Mexico. Quito, however, has moved with great caution for fear that such an agreement might leave the country too dependent upon SINOPEC, China's leading overseas petroleum investor. The Ecuadoran response highlights the residual concern that some smaller states have of Chinese investment becoming so significant that it will create a dependence that South American states ardently hope to avoid. With the region's

difficulties in the diversification efforts of the past, it is surprising—and a reflection of the unrealistic expectations—that more states are not heeding Quito's caution in moving full steam ahead in welcoming Chinese penetration of their economies.

Other Motives Than Energy

However, Latin America does not interest Beijing solely for energy resources; the region is an important source of a variety of other minerals and foodstuffs. Brazilian President Luiz Inacio "Lula" da Silva's May 2004 state visit to China highlighted the range of desirable items beyond petroleum, including uranium, soybeans, and aircraft. Indeed, one of the changes in China that has received little attention in the outside world is how China will feed itself. As China works to decrease its dependence upon a highly inefficient agricultural sector, food for the vast population is increasingly important. Buying that food from abroad, especially the successful agricultural products of Latin America, is a logical trade item for China and the region. As Latin American states are increasingly efficient at producing food, Beijing can buy at a more reasonable price than trying to reform agriculture at home.

South America is important for two other reasons as well. Brazil and Surinam, a remote and oft-forgotten state in the northeast of the continent, both offer space launch facilities with geography far superior to anything available in China. While ties to these states have not fully developed, the likelihood of Beijing increasing its interests there is high.

Additionally, South America is a region with which the PRC has a natural affiliation in its traditional role as "protector of the Third World." The South American experience with colonial and U.S. interventions over the past century has made Beijing's search for like-minded states to create a block in the international community to protect sovereignty against "hegemony" an attractive prospect. This is a natural area for ties to grow, as the power of the United States is so important to both the PRC and Latin America. It is easy for U.S. strategists to underestimate the importance of national prestige for all of these states. Informal alliances in organizations such as the United Nations, allow voting blocks to deliver messages otherwise difficult to convey to a hyperpower accused of unilateralism. Additionally, knowing that the United States will oppose any Latin American permanent membership on the Security Council is an easy "win" for China as it seeks to assume a more visible, leadership position in the world. If the truth be known, Beijing probably also opposes any expansion of the Permanent Five to anyone at all (certainly it opposes Japan and probably New Delhi as well) but can take political cover from Washington's more vocal position.

I find that since Hutchison-Whampoa, a Hong Kong-based company with activities across the globe, won the contract to maintain facilities at both ends of the Panama Canal, people speculate about possible Chinese influence over the operation of the Canal. One such speculation assumes the company has close ties to the PLA. On closer examination, it appears that there is a tenuous, if any, link between Hutchison-Whampoa and the Chinese military in Panama or anywhere else. The economic restructuring in the PRC in the 1990s meant that the PLA discontinued most of its financial links with non-military activities. Moreover, as one of many companies that operate in Panama, it is not clear why this speculation assumes this one company has extraordinary influence over the Canal, a facility rarely used by the U.S. military. First, with the changes taking place in the PRC in the 1990s, the PLA has been pressured to discontinue most of its financial links with non-military activities such as Hutchison. In exchange for withdrawing from the commercial sector, the PLA has seen hefty increases in its budget for the past decade. More significantly, Panama still retains recognition of Taiwan as the government of China. Indeed, Panama is seen by Taipei as "the jewel in the crown" of its formal allies around the world. If Beijing were as able to control Hutchison as is widely assumed, the first thing it would have done is to pressure Panama to switch recognition from Taipei. That symbolism is something that bothers Beijing profoundly and they would have moved quickly to remedy the "problem" that currently exists.

Finally, Beijing maintains a minor interest in Latin America because of increasing concerns about "Triad" activities in the Tri-border area (where Brazil, Argentina and Paraguay meet) as well as in Paraguay itself. Criminal syndicates operating in the area have been cited in international law enforcement's concerns about the growing transnational illegal activities in the Tri-border area. Beijing monitors this activity but has little control, since it does not have relations with Paraguay and the problem is not yet a major threat in the eyes of Buenos Aires or Brasilia.

Argentina, Brazil, and Chile

Argentina remains a broken economy with strained ties to Washington. Nationalist sentiment in the Republic is going to require considerable time before the

blame for the 2001–02 collapse of the economy and concomitant political chaos is turned on anyone but Washington. The Chinese interest, thus, is likely to be the least important in this state of the major economies in South America. Argentina has a number of investment projects, beyond energy, which interest China and are likely to continue the relationship into the foreseeable future.

Chile is the most stable economy in the region and will be of interest to Beijing for copper and food stuffs (second largest producer of salmon in the world behind Norway). Additionally, the predictability of Chile's economy, coupled with its desire to move into the Asia Pacific rim in a more concerted way, will make it an increasingly appealing site for Chinese investment. At the same time, Chile does not offer tremendous energy resources and it is a relatively small economy based on a small population.

Brazil is the state which is bound to have the greatest ties to China in the future and has the most that could potentially affect the United States. It is a vast landmass with a large population. More so than any state in the region, Brazil chafes at U.S. dominance of the western hemisphere and seeks to be on a par with Washington. Beijing appears a logical, welcome partner in endeavors to remedy the disparity. The space ties noted earlier along with food stuffs and research into alternative energy sources are easy connections between Brasilia and Beijing. For my money, it is this diverse set of shared interests, along with the practical sizes of the states and their populations, that make this the most important area for Chinese expanded influence and investment in the foreseeable future.

The Future Relationship

The potential for longer-term rivalry between China and Brazil, the likely South American leader, is currently ignored for the sake of creating better ties, as evidenced by President Lula's recent visit to the PRC. Beijing's path to increased interest and influence in Latin America will be marked by many bumps along the way. Latin America is an area of growing, logical interest to Beijing, but there is no reason to believe the southern hemisphere states will suddenly leap to the top of Beijing's priority list. The region may also grow skeptical of Beijing as the latter's power grows, and it assumes roles more in keeping with a superpower than a victimized state. Latin America is highly sensitive to states that can violate sovereignty issues at will, the essence of hyperpower status.

Beijing's interests in Latin America also include its quest to isolate Taiwan further by enticing Latin American nations to shift diplomatic recognition from Taipei to Beijing. Six Central American states, and Paraguay, recognize Taiwan as the government of China but Beijing will undoubtedly try to change that equation in the future as it continues pressuring Taiwan to abandon independence goals.

None of this is good news for Taiwan in the region. While the Hu visit focused on strengthening ties with South American states, it also emphasized how little Taiwan presence there is in that hemisphere, Paraguay being the sole state formally to recognize Taiwan instead of Beijing. Taiwan has given some indications that it hoped that other South American states might join those which recognize it by helping Taiwan with entry into various international organizations or pressing Beijing to accept Taiwan as a state. The success of Hu's visit made this already extremely remote possibility disappear in the reality of South American states embracing Beijing wholeheartedly.

Latin America probably read too much into the growing ties, as it did about Hu's highly successful visit last November. Beijing must now calibrate subsequent ties to maximize Chinese economic benefits from the region without alarming Washington. This will be an interesting test of the sophistication of Chinese strategy in Latin America.

For the immediate and intermediate term, Beijing will do nothing to upset its trade relationship with the United States. The access to the U.S. market far outweighs any possible benefits that China might gain from greater relations with Latin America, including access to Venezuelan petroleum. The desire to continue the economic growth that has given the Communist Party its ability to claim successes, hence keeping it in power, would be seriously undercut by any actions that caused Washington to shut off that market access. This risk is too high for the Party to take and this is a conscious calculation on the part of the Chinese leadership. The lesson of the Unocal uproar will reverberate in Beijing's thinking.

But, Beijing remains interested in exploiting all cracks in the Latin American system which would allow them access. These cracks may be microscopic, such as a relatively low level trade visit, or considerably greater, to include more visits by the heads of state from the region. Beijing can simply wait for the Latin American leadership to make the first moves and respond appropriately since the Latin American leadership is increasingly reacting to its growing frustration with the state of the

overall regional ties with Washington. As long as Washington continues to promote democracy and free trade in the Middle East to the perceived exclusion of Latin America, this region is going to reach to China as a market and as a counterbalance to the United States. While Latin America seeks to create this balance in an effort to get Washington's attention, it will increasingly benefit Beijing's goals of finding new markets, new sources of raw materials, food, and energy resources while also strengthening ties with a portion of the world where Beijing has had little historical connection but where ties in the future look lucrative and encouraging.

Cochair BARTHOLOMEW. Thank you. Mr. Santoli, welcome.

**STATEMENT OF ALBERT SANTOLI
PRESIDENT AND DIRECTOR, ASIA AMERICA INITIATIVE**

Mr. SANTOLI. Thank you. Madam Chairwoman and Members of the Commission, I'd like to look at this from a different perspective, which is the geostrategic perspective, not so much of just purely based upon economic figures or the fact that Brazil in its trade of aerospace and high technology is significant for 21st century military and security issues for just about anyone. To start with, I would look at it from a more ancient Chinese geostrategic strategy principle of the idea that you strike your enemy when you're weaker from the most exposed side of that opponent.

For us, the most exposed side is Latin America. If you look at right now the statements that were made this past week, again, threatening some kind of strategic encounter if we come to some kind of blows over Taiwan, besides the idea that there could be a strategic attack on the United States, one would have to look at our most vulnerable means of life support in this country, which is communications.

I would venture to say that what's being built right now in Cuba, in terms of their cyber warfare capability being done in at least three locations in different parts of Cuba, combined with the ongoing Russian cyber and electronic warfare capability and espionage capability at Lourdes poses a direct and grave threat to the United States, to knock out of our communication system. If we should be hit by a coordinated terrorist attack, if there's a strategic component to that also, if our communication system is knocked out, we are rendered in many cases relatively helpless in terms of emergency first response, also the ability of our military of coordinate. I would say on top of that, if you look at the statements that have been made by Fidel Castro in recent last two or three years, he's been crowing about defeating Yankee imperialism with cyber warfare.

I think for us this should be one of our key concerns. It's not so much the level of investment. It's not so much that we should fear a conventional military attack by China from Latin America, but it's the ability to do asymmetrical damage from bases there.

Or asymmetrical types of trade with countries like Brazil that would enhance their ability to do 21st century warfare whether it's from land satellite stations or anti-satellite capability and other things that would render us blind in a time of conflict.

If they're serious about eventually about some type of conflict in Taiwan, yes, the fact that there are so many Latin American countries that recognize Taiwan, there's going to be pressure like what just happened with the peacekeeping in Haiti, where kind of the price that Beijing after the fact was they wanted Haiti to de-recog-

nize Taiwan in order to give their vote to continue the peace-keeping operation.

This should give us grave concern about China's role in peace-keeping anywhere in the world and what their ultimate objectives are, but I would say that if we're looking at Chinese using modern techniques to ancient warfare strategy, they're going to be looking at where we are most vulnerable. They are also for right now in kind of a preconflict or hopefully conflict won't happen, but say it should five to seven years down the road.

What's going on now with the companies they're setting up in Canada, with the companies being set up in Mexico, with companies being set up in Panama and the Colon Free Trade Zone, in terms of technology transfers, dual use technology, in terms of organized crime and the ability to move weapons in and out and small arms, not major weapons systems, but small arms to drug armies or to street gangs in the United States, there's been cases on record with our Customs on all of these taking place through a combination of ocean-going vessels that are owned by in large part the Chinese military and their organized crime involved, working with companies involved with the Chinese military.

If you look at a number of cases of dual use technology transfers where we have prosecuted people, they have not been so much U.S.-based companies, but they have come from surrounding areas, primarily from Canada, but this again fits into an ancient game of "Wei Chi" or "Goh," where you surround your enemy, and the way you win the game is when the enemy is paralyzed, and what they're doing at this stage as an active military strategy, and they've written about this—if one reads Chinese military doctrine, they don't hide it—they look at their idea of asymmetrical or unrestricted warfare involving economics, natural resources, terrorism, drugs, espionage, across the board, where they say our military is not focused and doesn't understand that in the 21st century what they call the supranational levels of economic and communications are now fair games of war.

It's something that we need to wise up to. What's happening in Venezuela I think is indicative that we have to pay more attention to Latin America in terms of our development with, you know, Madam Chairman, you were talking about the need for development is absolutely essential, because the way that the Chinese will move in through the Cubans, through Chavez and his Bolivian revolution, is taking advantage of poverty in the region. I think we can do it better when we apply ourselves and we should use our own American ingenuity and the good hearts that we have as Americans to counter that with expanding our ability to do grass-roots economic development.

I think that's one of our best defenses so if we look at on one hand, for instance, the bases in Cuba that pose a threat to us with the cyber-electronic warfare capability, we need to find a way to take those bases out without hurting collateral civilian populations. That's essential, and we need to send the message loud and clear that we can take those facilities out and that politically we're not afraid to.

Secondly, I would say across the region to neutralize what the Chinese are backing Chavez to do and backing Castro to do, with

taking advantage of the poverty, is to be able ourselves to have better developmental programs that can be cost effective and would go a long way to stabilizing the region.

Thank you.

[The statement follows:]

**Prepared Statement of Albert Santoli
President and Director, Asia America Initiative**

China's Strategic Reach into Latin America

“Know the enemy as you know yourself and in a hundred battles you will never be defeated. Strike where the enemy is not prepared, take him by surprise . . . avoid the solid [strengths] and strike where [the enemy] is weak.”—Sun Tzu from “The Art of War.”

“In the 21st Century, the weak may defeat the powerful by employing supra-national methods of warfare, which professional Western military people are unfamiliar with. These include financial warfare, smuggling warfare, cultural warfare, drug warfare, [natural] resources warfare, psychological warfare and international law warfare.”

“The most basic form of ancient Chinese warfare is called ‘the side principle.’ This means to avoid clashing with the enemy’s powerful sword in a frontal collision, at his point of strength. But rather using one’s sword to cut into the warrior’s exposed side.”—From the strategic treatise, *Unrestricted Warfare*, published by the People’s Liberation Army Literature and Arts Publishing House, 1999.

Chinese geo-strategic practices of asymmetrical warfare, using both ancient techniques and modern “war by other means” targeting the “weak exposed sides” of the United States have been steadily and effectively growing during the past decade in Latin America. Chinese tactics are being used to gain political and economic influence, as well as military alliances and bases for cyber-electronic warfare. These developments are a critical challenge to the United States in a vulnerable resource-rich area on our doorstep that we have too often taken for granted.

In the mid-1990s, following the collapse of the Soviet Union, Beijing seized the opportunity to embrace the aging but still fiery leader of what remained of the anti-American socialist world—Fidel Castro. By 2001, in South America, the old “Brujo” Castro found an enthusiastic new apprentice in Hugo Chavez of Venezuela, who possessed leverage over the United States with large oil reserves—also coveted by Beijing—and the financial independence that Fidel had always dreamed of but could never before realize.

Beijing’s strategic plan to challenge—and eventually defeat the United States—is being utilized in Latin America, along with an aggressive worldwide cyber-warfare capability, which add to a massive blue water naval and intercontinental ballistic missile build-up. This build-up—funded in large part by its massive trade surplus with the United States—has been deceptively cloaked by Beijing’s new economic strength, seen as non-threatening by most of the West. Russia, Israel and certain Asian nations, have joined American weapons and military technology merchants to supply Beijing for its unprecedented military modernization. This has enabled Chinese military officials during a ten-year period to take a “great leap forward” in military capability and is enabling their geo-strategists to applying ancient martial traditions to “modern conditions.”

China’s new military doctrine calls for a total war of politics, finance, electronic communications, trade supremacy, manipulation of financial markets, and control of critical natural resources, especially scarce resources such as oil, cobalt and nickel, which are found in relatively few regions of the planet. At the same time, with no regard for matters of human rights, Beijing continued to mold political, financial and military relationships with resource-rich, non-democratic governments who deny those same scarce resources to Beijing’s rivals. Cuba and Venezuela should be included at the top of this list.

In addition, Chinese military planners have also advocated the dirty business of utilizing narcotics traffickers, international organized crime networks and terrorist organizations—such as the shadowy al Qaeda network—that could sap a great Superpower of its financial strength, military confidence and national morale. Latin America, and particularly Cuba’s proximity to the United States and its radical leftist networks throughout the region, have provided Beijing the opportunity to utilize its strategic plan of “unrestricted warfare,” where the weak can defeat the powerful through unconventional means.

By the dawn of the new Century, a mere decade after being politically isolated because of the Tiananmen Massacre of its own emerging young democrats, China had achieved an astounding feat to become a world military power, confident that it will eventually dominate all of East Asia. A key to this strategy appears to be keeping its chief rival—the United States—bogged down with tactical and strategic instability in our own hemisphere.

The first step was achieved on December 31, 1999 when the United States gave away the Panama Canal, its crown strategic jewel in Central America. An opportunity seized by China, whose businessmen bribed the corrupt Panamanian government to obtain control of the trade lifeline between the Atlantic and Pacific Oceans. This acquisition of a 50 year lease—through one of Beijing’s “patriotic businessmen,” Li Ka-shing of Hong Kong—enabled China to gain enormous political and trade involvement in the region. In addition, U.S. military bases in Panama, essential for regional training and conducting interdiction of narcotics in the neighboring Andes region, were permanently closed. It was at this same time that many Latin American governments began forging stronger economic, political and military ties with Beijing.

Not only does the role of China in Panama expand Cuba’s access to its vital lifeline for commercial acquisitions: the Free Trade Zone at Colon, but Li Ka-shing’s Hutchison Whampoa company’s stevedores control the loading and off-loading of thousands of commercial ships that pass through the Canal Zone. Add to this a massive influx of mainland Chinese businesses into the Free Trade Zone—and the growing presence of Communist Chinese intelligence operators and the “patriotic Triad” organized crime syndicates. This has escalated, not only along the Panama Canal, but also in the region’s other major shipping hub at Freeport, Bahamas.

The control of stevedoring—the loading and offloading of ships gives China the ability to bring weapons and countless illegal aliens into the hemisphere—including possible terrorists, who, in partnership with Cuba and Venezuela, could prepare new terrorist cells to cross into the United States through our porous southern border with Mexico. The stevedoring also permits China to facilitate the transfers of sensitive dual-use military and hi-tech products and components back to China, and the transfer of weapons to guerilla and narco-terror groups in the region without the scrutiny of U.S. Customs or intelligence agents.

This threat was highlighted in July 1999, when a Panamanian interagency police force—aided by soon-to-depart U.S. agents—seized a shipment of automatic weapons in Panama’s Atlantic-Caribbean port of Colon, known as a gathering place for organized crime and terrorist organizations from across the world. Reports from Panamanians residing in Colon’s huge Freeport area now state that the area is dominated by Chinese organized crime syndicates.

On a parallel dynamic track, the expanded Chinese role in Latin America gave Fidel Castro new life, rescuing the Cuban communists from the death throes of abandonment by their collapsed Soviet benefactors. Havana was maintained, in part, by the backing by new neighboring leftist regimes such as Venezuela and massive corruption in surface pro-Western countries such as Panama. The Castro regime, however, was especially resuscitated by Beijing’s political, economic and military support.

In June 1999, the international press, such as Agence France Press, began reporting China was using Cuba as a sensitive military listening post to monitor broadcasts and telecommunications in the United States; and between August and September, high level military and trade delegations from Brazil, Ecuador and Uruguay sought Chinese funding and state-to-state support for their respective agencies. Almost all of the China-Latin military agreements called for some forms of training support and official exchanges with the Chinese People’s Liberation Army.

The most dramatic State visit to China during the 1999 pre-hand-over of the Canal was made by Venezuela’s Hugo Chavez. In Beijing he emphasized to international reporters, “I have always been a Maoist.” He proclaimed, “Venezuela is lifting itself up just as China lifted itself up 50 years ago by the hand of Mao Tse-Tung, the Great Navigator.” During this visit, Chavez began signing a series of oil and political agreements that led to Venezuela purchasing Chinese military equipment within the year and the arrival of PLA military trainers in Caracas.

In 2002, following the failed civic effort in Venezuela to overthrow Hugo Chavez, American military trainers were withdrawn from Venezuela. Almost immediately, they were replaced by Spanish-speaking Special Forces trainers from the Chinese People’s Liberation Army. And during the same period, Chinese Air Force trainers arrived in Venezuela as instructors for a new fleet of airplanes purchased from Beijing by Chavez. Venezuelan military officers, who opposed Chavez swinging the country into the Cuba-China axis, told of al Qaeda terrorists being moved into Venezuela—either through direct flights or transiting from Panama—and met at the

airport by Chavez regime operatives and given new identifications before “disappearing” into the Venezuelan countryside.

In a seminal strategic text published in 1999 by the People’s Liberation Army Literature and Arts Publishing House, titled “Unrestricted Warfare,” the authors described Beijing’s new strategy for defeating the United States and its allies. Senior Colonels Qiao Liang and Wang Xiangsui, state that the technological world is entering a new era of unprecedented peril—ripe for military exploitation. They explain that the technological revolution has increasingly blurred the boundaries between military and non-military, transcending all boundaries and limits of combat.

Adopting ancient martial arts theory and practice to the hi-tech era, they explain how the “strong can be defeated by the weak” through merciless unconventional methods. As examples, the authors make repeated references to enemies of Western society, such as Colombian drug lords, the Italian Mafia or Chinese Triads who now permeate Latin and North America, and then-considered “new terrorist” Osama bin Laden and his shadowy network. They also champion the skill with which George Soros used “economic attacks” on monetary systems to infiltrate and then take down the economies of entire countries.

The strategists intensely focused and unsentimental doctrine clearly demonstrated that the People’s Republic of China is preparing to confront the United States and our democratic allies by conducting “asymmetrical,” or multi-dimensional attacks on our most vulnerable soft-targets. This new form of warfare, which borrows from ancient Chinese warfare doctrine of surprise and deception, utilizes civilian technology as military weapons, “without morality” and with “no limits” in order to break the will of democratic societies.

Chinese military strategists intensely studied the lessons of Desert Storm. They found that the American military is obsessed with expensive high-tech precision weapons and deluded by the ease of the overwhelming conventional victory in the Iraqi desert. However, in subsequent theaters of low-intensity conflict such as Somalia, terrorist attacks in North Africa, and in the first attack on New York’s World Trade Center, as well as in penetration of sensitive governmental and economic sector Internet sites by amateur computer-hackers, America’s power was relatively ineffective.

There is no place less adequately defended in the United States than our land, air and sea borders with Mexico and Latin America. Cuba, Panama and Venezuela, combined with socialist drug lords in Colombia and newly-elected leftist leaders such as Lula de Silva in Brazil (who is providing Beijing with aero-space assistance) have given Beijing a consortium of willing allies who idolize Fidel Castro’s socialism. Their regimes can also be saved—as has Castro’s—by the combination of energy assistance from Venezuela and financial, trade and military assistance from Beijing. This will further enable China to sustain an anti-United States consortium across the region.

In “Unrestricted Warfare,” the PLA author-Colonels describe the “most basic article” of ancient Chinese warfare, the technique they call “the side-principle.” In ancient times, this referred to avoiding clashing with an enemy’s powerful sword in a frontal collision, at his point of strength, but rather using one’s sword to cut into the warrior’s exposed side. In other words, applying deft skill “to cut things apart without one’s sword being damaged.” For America, which increasingly embraces a “globalist” future, our vulnerabilities involve areas of global economics, communications, information and culture that we consider to be non-military in nature.

Chinese strategists believe that the Western military has not yet fully understood the utilization of private or multi-national corporations as instruments of warfare. This is borne out in recent events, such as the relative ease at which Chinese companies owned or controlled by the Communist government or their allies have entered American capital markets. It is also exemplified by the lack of national security concern in Washington when Beijing cronies, such as Li Ka-shing and his Hutchison Whanpoa Ltd. corporation gain control of strategic ports in the Americas, such on both ends of the Panama Canal.

If American officials had taken Chinese military doctrine more seriously, even before 9/11, they may have begun tracking the al Qaeda links to the Chinese military through their Pakistani allies—who supported bin Laden’s jihad against India and the West.

We should also take seriously the developing shift in allegiances in Latin America. On April 30, 2005, during the international Labor Day weekend Castro and Chavez appeared together in Havana’s Karl Marx Theater in a meeting with free trade opponents from throughout Latin America. The two caballeros hammed it up for international reporters and ridiculed the United States failures throughout Latin America, and vowed to build effective leftist alternatives to U.S. policy in the region. Appealing to massive poverty-stricken Latin Americans disillusioned with the promise

of American style free markets, Chavez, backed by Castro, countered with his own plan in 2004—the Bolivian Alternative for the America [ALBA]. “We must congratulate Condoleeza Rice for the failure of the FTAA [Free Trade Agreement of the Americas],” Castro roared, calling it a plan for U.S. multi-national corporations to exploit the poverty of its southern neighbors. “The FTAA is dead, ALBA is coming,” Castro exclaimed. Thus far, however, the only country to join ALBA is Cuba, which relies heavily on Venezuela for cash assistance and oil, while China provides military and technical assistance in place of Castro’s former benefactors—the cash-strapped Russians.

In a recent article, American expert on Cuba, Otto Reich, wrote, “With the combination of Castro’s evil genius, experience in political warfare and economic desperation, combined with Chavez’ unlimited [oil] money and recklessness, the peace of this region is in peril.”

Chavez, emboldened by support from Cuba and China, is being accused in the Latin American media of coordinating the removal of Ecuadorean President Lucio Gutierrez in Spring 2005. Gutierrez had tried to model U.S. policies on trade and hosted U.S. military bases for counter narcotics operations in Colombia, whose government has also sought economic, political and military assistance from Beijing. U.S. intelligence has said that Chavez has financed violent insurgent groups in Ecuador, Peru and Bolivia. Not coincidentally, Peru and Bolivia are also oil producing nations, whose resources are vital to U.S. stability.

Chinese military ties to Cuba, while not offering an immediate conventional military threat to the United States do in fact enable Beijing to open an asymmetrical cyber-warfare base near America’s shores. U.S. military Southern Command’s top General, Bantz Craddock, told the U.S. Congress that in 2005, Chinese military officials have made 20 visits to Latin America and the Caribbean region, and military delegations from nine Latin countries made official visits to China.

A high level U.S. security official recently told the Miami Herald newspaper that Cuba is already a direct threat and potentially other Latin American countries, such as Brazil, could host Chinese cyber-warfare and satellite stations that could seriously harm the United States. “We know that China has made a top priority of this knowledge-based warfare,” the official said. “As other Latin countries tighten defense and economic links with China, some may be tempted to think that ‘We can get away with letting China do these things here.’”

Both Venezuela and Cuba are receiving overt and subtle military assistance from China. Beginning in the year 2000, China and Cuba began publicly signing wide-reaching economic, political and military assistance agreements. Equally important, to enhance its offensive asymmetrical military options against the United States—especially if war should break out in the Western Pacific, the Sea of Japan, the South China Sea or in the Taiwan Strait—China was able to obtain major listening posts and communications jamming stations in Cuba. These stations could also be used for sophisticated cyber-war and electronic jamming capability that could paralyze parts of U.S. command and control of coordinating its Atlantic and Pacific based forces during wartime.

In July 2005, the threat of a Chinese nuclear first-strike against U.S. major cities was stated publicly by the Dean of China’s National War College. Before or after such a cataclysmic attack, electronic warfare out of Cuba to jam U.S. emergency broadcast communications would debilitate U.S. emergency response systems causing further widespread chaos and casualties.

It has been confirmed by international media that China is operating a sophisticated electronic spy system in Cuba against the United States. Castro is also taking pride in what he calls “electronic warfare against the Yankee imperialism” according to intelligence sources and government agencies.

“For China the utilization of Cuba as an electronic spy base is of great importance because of its strategic location in the United States’ backyard,” commented a former U.S. intelligence officer. The Chinese electronic spy bases have been camouflaged under a pretext of collaboration between China and Cuba in the field of electronic and radio communications, who signed expanded agreements in February 2004 during a visit to Havana by the Chinese foreign minister, Chi Haotian.

The main Chinese electronic spy bases in Cuba are located to the northeast of Santiago de Cuba in the far east of the country and in the Bejucal area in the province of Havana, according to intelligence sources. The base of antennas in Santiago de Cuba is mainly dedicated to the capture of U.S. military satellite communications, meanwhile in Bejucal the Chinese have created a complex interception system of telephone communications.

To disguise these activities, the official Chinese station, Radio China International is transmitting its programs from Havana to the United States and Latin America.

“The transmissions of Radio China International are originating from Havana on the station 9570.0 KHZ,” an international FCC report confirmed. The FCC situated the transmitter of Radio China International at 22.56.00 North and 82.23.00 West near the city of Bejucal, to the southwest of Havana.

“Cuba is now interfering low and high band frequencies, with a strong transmitter, like never done before,” the FCC report indicated. “On some occasions the interference is so strong that it sounds like Star Wars,” the report added. According to U.S. official sources, during the past few years Cuba has been conducting electronic interference up the U.S. East Coast by using strong equipment of high band frequencies, including disruption of radio communication traffic in New York.

“The Cubans are interfering with air traffic communications and have even made false transmissions to the air traffic control tower in New York,” a memo from the FCC confirmed, which was obtained by the Miami El Nuevo Herald.

These interferences, captured by U.S. electronic monitoring services, have located the sources southeast of Havana and in the province of Pinar del Rio. On May 13, 2001 at 4:48 p.m. a false transmission made to the control tower in New York was produced from Pinar del Rio and its origin was located at 22.12 North and 83.34 West. “On this occasion the conversation on a high band frequency falsely identifying itself as ‘OPEC21,’ a U.S. military flight (C130 plane),” underlined the report.

“This is such a delicate topic that it is practically being treated in a secret manner due to its political implications,” the source commented. The Chinese bases are in addition to the electronic spy stations that Russia operates in Lourdes province of Havana, for which Cuba receives \$200 million annually.

The growing political, economic and military relationships aggressively pursued by China on America’s doorstep, are centered around its relationship with Fidel Castro, the region’s still-vibrant anti-America political warfare practitioner and his oil-rich protégé Hugo Chavez in Venezuela. This presence, coupled with China’s growing political and economic influence, with its submarines now ready to be equipped with nuclear multiple-warhead missiles, pose an encircling military threat to the United States, never before seen in our nation’s history.

In effect, the Chinese are engaged in building a multi-dimensional strategic and tactical surrounding of the United States: on the Latin American land mass and islands, beneath the Pacific Ocean waves and in aero- and cyber-space. A new generation of well-schooled and determined Chinese strategists, have become grand masters of the age-old Chinese game of strategy called “Wei Chi” or “Goh.” In a Wei Chi contest, a player makes the decisive winning move when his opponent is completely surrounded and unable to maneuver, as in the clutches of a python. In effect, we could label China’s growing strategic ties with Havana and other Latin American nations, as well as the ability to attack from the sea and in cyber-space makes the ancient Wei Chi technique far more effective today.

What can be done to counter China’s moves into Latin America? I recommend the following:

- First and foremost, we must not take our southern neighbors for granted, militarily, economically or politically. Efforts must be made to budget American developmental resources towards cost effective grassroots economic development programs to counter strategic humanitarianism such as Chavez’s Bolivarian populism and Castro’s medical teams.
- U.S. policymakers should make a thorough review of the Monroe Doctrine to see how it may be applied to today’s developments in the region.
- U.S. policymakers should not take for granted the renewed anti-U.S. alliance between Russia and China, whether in Eurasia or in Latin America, including intelligence and organized crime networks.
- In the 21st Century, electronic- and cyber-warfare bases in Cuba are as serious a threat to U.S. security as Russian missiles were in the 1960s. There should be counter-measures developed to neutralize these bases without creating collateral casualties to Cuban civilian populations.
- Training of Latin American military officers should be preconditioned with a ban on these officers from attending military training or observing war games in China.
- Although it may be a late effort, a review of how Hutchison Whampoa received the Panama Canal ports contract should be reviewed by U.S. Congressional and Trade Commissions, with appropriate action taken if corruption is proven.
- Hugo Chavez in Venezuela should be seen as more dangerous to the United States than any Middle Eastern dictator. A variety of methods should be made to strengthen the Venezuelan opposition movements against Chavez.
- China should not be permitted to participate in United Nations peace-keeping missions in the Americas. Beijing’s behavior on politicizing the Haitian peace-

keeping mission should be an indicator of China's negative intentions today and in the future.

- American policymakers, counter-intelligence and military officials should be required to study the same texts, ancient and modern, on geo-strategy and war fighting that are studied and practiced by Chinese military and geo-strategy officials.

Panel V: Discussion, Questions and Answers

Cochair BARTHOLOMEW. Thank you, Mr. Santoli. Thank you to all of our panelists. Commissioner Wessel.

Cochair WESSEL. Thank you all for being here. Mr. Loser, I'd like to go back to one of the facts you used. In looking at your charts, it's a little hard to see from here, but looking at the charts, if I remember the growth rate in the Latin American trade, from a small base clearly, but was 260 percent, if I remember, which is a fairly striking increase over a fairly short period of time. I believe it was a five or six year period.

Clearly our overall numbers have grown, but China's penetration and activities in Latin America are growing rapidly. I want to also correct Dr. Watson, one comment, that this may be the first public hearing to do a walk-around the world, but we have looked at Latin America in some of our briefings and other activities, but clearly we are accelerating our activities.

We now have a free trade agreement with Chile. CAFTA will be voted on in the House next week. The Administration is negotiating an Andean Free Trade Agreement. Their negotiating seems to be pretty much on the shelf a Free Trade Agreement of the Americas. How does China see those activities? Does it believe that it has some ability to gain a foothold in Latin America with more robust relationships. You may have heard some of the previous panel in terms of sort of either/or activity or can we coexist in the region? Is China just looking at resources or as discussed with questions about Taiwan, is it looking for deeper political relations and more? For all three panelists.

Mr. LOSER. Okay. Yes, the rate of growth has been very significant in recent years. Actually in the year 2004 relative to 2003, the rate of growth was over 50 percent. Now, this had to do with a combination of high prices for soybeans and an increased demand so that there was a particular aspect to it, but fundamentally China had not looked into Latin America and now it's coming in, and it's demanding high levels of agricultural goods.

Of course, there, in terms of agriculture, the type of agriculture that China demands, the U.S. is a competitor of South America in the sense that it is exporting the same type of goods. In a way, both American farmers and Latin American farmers are benefiting from the high demand for agricultural commodities. In terms of other items like copper there is less so. But again, it is something where I believe that China and the United States can coexist without difficulty.

In terms of the overall strategy of the United States with regard to trade agreements, fundamentally it's more a question of the Latin Americans wanting to have a secure market in the United States, say CAFTA, Mexico within NAFTA, the Andean Group as well. Mercosur is a different story. I won't go into that.

But fundamentally they want to gain or guarantee some degree of access to American markets. So it's Latin America competing with China in the U.S. market and in that sense, you can coexist. Fundamentally it is expected that China will increase its presence in terms of textiles significantly in the United States and Latin America will decline. There will have to be a restructuring of the economy.

But I do not see the situation maybe with the exception of oil as one of conflict, but one of possible reasonable coexistence.

Cochair WESSEL. Other panelists?

Dr. WATSON. I would agree. I think it's the situation right now of coexistence. I think that China's primary interests are much greater right now in other parts of the world, and there is no need in their minds to make this into an either/or in Latin America. I don't even think that when it comes to petroleum in the case of Venezuela, I'm not convinced in the long term that that's going to be all that significant.

When push comes to shove, China has too much invested both in the economic sense as well as in the political sense in the relationship with Washington to try to screw that up by pushing in Latin America. There is no conceivable way that it is worth jeopardizing economic ties and access to the U.S. market in order to get into Latin American markets. Would that be true 30 years from now? Not necessarily.

But I can't right now see any reason why they would shift their priorities because the U.S. market is simply too important to them.

Cochair WESSEL. Thank you.

Mr. SANTOLI. Well, all bets are off if there's an international conflict or if there's an international shortage of oil or something that would create instability in China where they would be much more apt to take us on and to create problems in other parts of the world.

For example, I'll give you an example of how they're using the economic presence to enhance their political and military relations with the local countries. In a statement this year by our SOUTHCOM commander which echoed what I heard from SOUTHCOM six years ago, as China's economic activity has increased in Latin America, its contact with Latin American military has gone up even at a higher percentage.

The most critical thing, and this is twofold. Number one, many of these Latin American officers have trained under the U.S. system. Many of them go to China and take part in war games where they are the blue team. The Chinese learn American military strategy and psychology from these officers. They are preparing for a conflict five, ten to 20 years down the road, and we have to accept that as reality.

In all of their writings, we are the principal enemy. If there is a conflict with Japan, a conflict with India or a conflict with Taiwan, or directly maybe with us. This is going to be an important area of destabilization. They would want us destabilized in our own hemisphere.

Secondly, Venezuela. In spring of 2002 when Hugo Chavez was almost overthrown, American special forces pulled out. Imme-

diately, within two weeks, Chinese special forces came in to train the Venezuelan military with Spanish-speaking soldiers.

Right now in Venezuela, and there is a direct tie here to terrorism and to drugs and the narco-terror system, there is international involvement between Colon in Panama where Colombia, Venezuela, and if you go to Colon, it's like that place in Star Wars where like every bad element in the world from the PLO and other groups to just about every organized crime group, Russian mafia, everybody is camped out there because it's a free trade port on dollars, and it's wide open and since we pulled out of Panama, we don't really have much of a presence there to monitor anything.

In the Venezuelan military, many Venezuela military officers came here to try to warn us that through Panama and Venezuela, as with the same time we were winning the war in Afghanistan, many al Qaeda people were coming through Panama and coming through Caracas. They were being met at the airports by Chavez' people and then being moved down to the tri-border area, where they could buy off the old Hamas groups down there because they had the money from the drugs and forming new—as we were busting, as our FBI was busting older groups here in the United States, the terror groups, new groups are forming there backed by Castro, by Chavez, the Russians and the Chinese.

What the Border Patrol talks about now, a lot of OTMs, other than Mexicans, coming across the border, many of whom with Arabic writing and text and what not. Some of them you could bet your bottom dollar are these people that are being brought into our hemisphere, staging and training, in these places where China has given political and military support like in Venezuela and moving up.

So I won't go any further, but that needs to be looked at also, is this involvement of organized crime and terrorism with Chinese role in the region.

Cochair BARTHOLOMEW. Thank you. Chairman D'Amato.

Chairman D'AMATO. Thank you, Madam Chairman, and thank all three of you for this testimony. It's certainly very disturbing to me and I know other Members of the panel to look at Chinese activities in the hemisphere. I think they are very sophisticated and haven't been there very long, but they seem to be doing quite well given the time that they've been operating.

I'm very interested in the remarks on cyber war. As I understand it—I haven't read it yet—but the DoD report that's just been released—does it make reference? Have you seen that?

Mr. SANTOLI. I've seen reference to it and I've seen statements of DoD officials that have expressed strong, strong concern about the level of the cyber warfare capabilities in Cuba.

Chairman D'AMATO. Yes. I think that's very interesting, something that this panel would like to look into further what you're talking about. There is some conflict about whether the Lourdes facility is open or closed. We've been told that it was closed.

Mr. SANTOLI. The Russians still have some presence there, but most of it has shifted to the Santiago de Cuba, the Bejucal, and there is one other location as well, that's more of a transmitting station for Radio China as they're stepping up their broadcast,

propaganda broadcast in the region. But the other two bases are hardcore cyber-warfare bases.

Chairman D'AMATO. Very disturbing to us. I'd like to ask Dr. Watson, you've talked about Latin America. Did you follow the visit of President Hu Jintao to Latin America and how would you evaluate the effectiveness of that visit diplomatically on a scale of say one to ten?

Dr. WATSON. I think it was extraordinarily effective, but not necessarily for the reasons that are largely remembered now that we're about seven, eight months after it happened. I go back to something that I mentioned in my remarks as my second point, and I think this is very important.

Latin America had major expectations of evolution in U.S.-Latin American relations. This is a part of the world, I realize this is not a Commission that's looking at Latin American affairs, but as Mr. Loser and I can talk about, this is a part of the world that over the last quarter of a century has seen their standard of living in most cases drop dramatically, has seen countries where in one particular case, you had four governments in ten days under a system that had long been frankly a democratic system.

This is a part of the world that has not necessarily had a good time in the last 25 years. That relates to Cuba in the sense that, to China in the sense that there has long been an expectation that we wanted to treat them as partners, and Latin American can be overly sensitive to not appearing that it's being put down.

Latin America didn't go through the same experience that East Asia went through. Latin America's colonization period was much earlier and one would think that they would have, quote, "gotten over" that, to quote someone from this town a long time ago.

But unfortunately, there is a residual feeling that the region has been underappreciated. Every time we say we're interested, it's only because there's a crisis, and then we turn away again.

At the same time, Latin America, I think can be somewhat unrealistic about understanding that we are a global power and we therefore have interests that shift. Hu Jintao made a visit where he came in and was the new guy with the new toys. He was a novelty. He was something different. Here was China coming all the way across the ocean. He wasn't the first Chinese leader to visit Latin America but coming across and saying I am coming to Santiago, but my goodness, I have all these other places that I can visit along the way.

The term that I've used in the testimony is that Latin American became giddy. I think that's noteworthy and I think he left a memory in their minds that was a significant one. However, I would go back to the point again that Mr. Loser made that when it comes to the foreign investment that was promised, not very much of it is there, and frankly I think it was a visit that was real long on form, but very light on de facto substance.

You have to also contrast that with President Bush's particular experience on that visit. There were a whole series of things that from the U.S. perspective went wrong in a public relations way in Santiago and then the President made one stop in his only major ally in the region, and Latin America is not an area where there are a lot of allies for the United States on the issue of the Gulf War

and a number of other things. He made that stop and then he turned around and went home.

So here is that contrast. Hu Jintao out with the masses in some of the large cities. President Bush stopping on an island retreat off of Cartagena and then coming home. That memory is perhaps superficial, but it's one that will endure, I think.

Chairman D'AMATO. That's very interesting. So the imagery of American diplomacy is greatly lacking here. But you're also saying that there is more image than reality in terms of the Chinese presence at this time.

Dr. WATSON. They hit the right notes.

Chairman D'AMATO. They hit the right notes.

Dr. WATSON. They knew the right notes.

Chairman D'AMATO. But the opportunity for America to go back into the region with a better, more substantial, diplomacy, given the needs of the region right now would pay great dividends.

Dr. WATSON. Yes. I would say that if the heads of the U.S. Government, and by that I mean the President, the Vice President, the Senior Members of the Cabinet, Secretary Rice has been to the region and I'm not denigrating that, but it often appears to Latin Americans that it's a "check-the-box" function.

If we went more often—the other thing I would say and then I'll end with this. The SOUTHCOM Combatant Commander is often seen in Latin American eyes as the most frequent visitor by the United States to the region. That's fine, but to a region of the world that you're telling you want to become democratic and keep the soldiers in the barracks, there's a very mixed message there, and it appears that all our interests in the region are military solutions when they think they have other problems.

Cochair BARTHOLOMEW. Mr. Loser, you looked like you had some comments?

Mr. LOSER. Two small comments. First, just to illustrate what Dr. Watson was saying. If you look at that chart there at the bottom, the lowest line is Argentina per capita income—it's in Spanish—I apologize for that—but Argentina is the red line, but immediately above that is Latin America. GDP did not move from '79 to 2004. East Asia which is basically China and others is the line on top. This is what's happening in relative terms to per capita income.

So there is an element there.

Commissioner MULLOY. Who's in between?

Mr. LOSER. The pink one is the developed economies, and the green one which is almost coincides with the pink of developed economies is developing economies which is very much influenced by the presence of China. Of course the levels are different and we can talk about that for a long time.

Now, I want to mention one thing about the presence of China. The Chinese president made a tremendous impression in Brazil, made a tremendous impression in Chile. In my own country, Argentina, it did not, but it was because the Argentines had high expectations about China being totally interested in helping Argentina, giving them \$20 billion in cash—that you can read in the newspapers—to pay back the IMF. And therefore to break the links with the international organizations and the U.S.

The Chinese, and here I want to reaffirm what Dr. Watson said, is they obviously thought, look, we have to protect our relations with the industrialized world. The Argentines were extremely disappointed with the fact that they didn't get that much help and also the Chinese were very hard bargainers. The Chinese wanted to have recognition as market economies which is extremely important for them.

And the Argentines, the Brazilians, and the Chileans were extremely shocked to find that the Chinese had in mind their interests, not the interests of the Latin Americans, and this is very interesting because they were expecting in a very unrealistic fashion that China would be a nicer, big power compared to the United States and they discovered that there was nothing like that.

Cochair BARTHOLOMEW. Thank you. Commissioner Dreyer.

Cochair WESSEL. But they did get their market economy status.

Mr. LOSER. Exactly, because they are very worried about maintaining the market share in China.

Cochair BARTHOLOMEW. Commissioner Dreyer.

Cochair TEUFEL DREYER. Well, as a very eminent European we talked to right after that said, whatever that deal for soybeans was, let me make up a number—\$18 million—and he said “what's the price of a non-market economy?—\$18 million.”

And apropos of the Latin Americans being surprised that China turned out to be a hard bargainer with its own interests in mind, I'm reminded of the speech that Fidel Castro made in Havana stadium in 1964—you may remember this one—in which he said he didn't kick out one group of imperialists, meaning the United States, in order to take on another group of imperialists, by which he meant China.

So apparently these lessons were forgotten. I was very interested in Mr. Santoli's allusion to cooperation among crime organizations in Colon, and I was wanting to ask all three of you about a rumor which one persistently hears in Miami, about cooperation among Chinese intelligence services and those of some Latin countries. In this case the rumors concern Venezuela and Cuba and China. Have you heard anything about this or is this just the Miami rumor mill or none of the above?

Mr. SANTOLI. Well, if you look at the military agreements that have been signed between Cuba and China, Venezuela and China, the visits that have been made to China by Hugo Chavez, the visits of—multiple visits of Chinese military and intelligence to both Cuba and Venezuela and the activities that are, quote, “anti-imperialist” that are going on in coordination between the three, even if it's not stated in big flashing lights, it's very obvious that there is cooperation, and you cannot separate the organized crime activity from national intelligence activity when it comes to operating in strategic areas close to a primary opponent or rival.

So all one has to do is look at the modus operandi of these various powers, and I'll look at China, knowing the way that they operate and knowing their doctrine and strategy. And it's very obvious. The same way that when we pulled our people out of Venezuela, as we were moving our people largely out of Panama, who moves into the largest bank in Panama? The head of Chinese intel-

ligence for the region. And that made a big impact on everybody throughout the entire region.

Cochair TEUFEL DREYER. So you would add Panama then to the list of cooperating countries?

Mr. SANTOLI. Well, I would say Panama is basically just corrupt. I don't think they necessarily have strategic agreements. I think they just can be bought and sold very easily.

Cochair TEUFEL DREYER. Thank you. Dr. Watson.

Dr. WATSON. I am far less concerned frankly about the military links between Venezuela and anyone. The Venezuelan military is extraordinarily inept.

Cochair TEUFEL DREYER. Intelligence, not military.

Dr. WATSON. Well, Mr. Santoli has mentioned military in a broader way a couple of times.

Mr. SANTOLI. Terrorism is different.

Dr. WATSON. I may be in a minority in this city, but Hugo Chavez Frias strikes me as a man who is getting a lot of the attention that Fidel Castro used to get, but he's doing everything he can to claw to keep in power. He's sitting on the very sort of economic disaster that Beijing is trying to avoid. What do I mean by that?

I'm not mixing up two different economic systems. Venezuela has proven extremely able to waste resources in a way that ought to shock any government that has petroleum. You were asking Ms. Bartholomew about petroleum states in Africa on the last panel. It's hard to find a state that has been as inept as Venezuela has been. You have a growing population that isn't satisfied with anything its government does as a result of corruption, waste, et cetera, et cetera.

This is man that's trying to find a way to rein in that population to stay in power. If he needs to dance with China to do that, he will dance with China, but I'm not nearly as convinced that intelligence cooperation between Venezuela and China is the threat that Mr. Santoli is right now.

Twenty years into the future, that's possible, but I can't see 20 years into the future.

Cochair TEUFEL DREYER. Nor can anyone else.

Dr. WATSON. So I can't be positive.

Cochair TEUFEL DREYER. Thank you. Mr. Loser?

Mr. LOSER. I have no knowledge about possible cooperation in terms of security or in terms of intelligence between China and Venezuela. I would not be surprised, but I have no basis to know.

Cochair TEUFEL DREYER. Thank you.

Cochair BARTHOLOMEW. Thank you. Commissioner Mulloy.

Commissioner MULLOY. Well, listening, Dr. Watson, you're with the National Defense University.

Dr. WATSON. Correct, yes.

Commissioner MULLOY. I remember reading a book about President Kennedy in 1961 and '62, he sent two observers to Vietnam, and they came back with completely different assessments of what is going on, and he said I—he went to the same country—you remember that old story.

Dr. WATSON. Yes.

Commissioner MULLOY. Hearing you and Mr. Santoli, I'm really struck by the different assessments that you have. You're picturing

a China that is quite cognizant of what it's getting out of trade with our country, which I agree with—\$200 billion and growing—trade surplus—that would be very cautious about its activities in South America and Latin America.

And Mr. Santoli draws quite a different picture for us. Mr. Loser, you're quite familiar with Latin America and studied it. Can you give us your assessment. Where do you line up on this?

Mr. LOSER. I can only say that from the point of view of Latin Americans, there may be some groups, there may be groups and maybe even terrorists that have radical views, that see China with interest, and there may be contacts, but fundamentally, the presence of China in Latin America is seen as a trade related and an investment related issue.

They may see a diversification your sources of money relative to Europe, relative to the same Latin America, relative to the United States, but in most cases even capturing the discussions in the newspapers, there is very little other than the economic area that I can perceive as important.

Commissioner MULLOY. Let me give you my impression. I went to Argentina, Chile and Brazil in the year 2000 when I was in the Commerce Department, a political official there, and I had the strong impression that all these countries wanted closer economic ties with America. Their children were being educated, a lot of them, here, and that we kind of ignored the region in this pursuit of East Asia.

I got that impression. I look at East Asia and I said our trade balance with them—we're selling them about one-half of what we import from them, so it's just completely imbalanced, and I thought with Latin America, we probably could have had a much better balanced trading relationship and maybe more integrated more fully into what—do you have any impression on that? Or was that complete mistake on our part and is there anything we can do to rectify it?

Mr. LOSER. Well, I strongly believe that United States in practice has forgotten Latin America. That Latin America except for strategic issues like in the case of Colombia, issues like Cuba and Venezuela, is almost a footnote except for Mexico and the Free Trade Agreement of the Americas where the various bilateral agreements with Chile, with Central America, have a role.

But fundamentally, the United States, if you were to ask in a closed room, without too many microphones, what the preference would be for Latin American leaders between being part of an economic union or an economic trade agreement with the United States or with China, there would be no question that they would prefer the United States.

There are issues about the national sovereignty. There are issues of national pride, but fundamentally this is what they want. The Free Trade Agreement of the Americas, which is now stalled, not only because of the United States, but also because of views on the part of Brazil or Mercosur, would be a great solution to solve this problem.

It's not the only solution, but fundamentally it would be tremendously important for the United States in helping to pay more at-

tention to the backyard than it has done over the last several years.

Cochair BARTHOLOMEW. Thank you. Commissioner Donnelly.

Commissioner DONNELLY. Thank you. I'll try to be real brief, but I would like to tease out the Venezuela discussion for a moment. And I'll allow that in so many ways Hugo Chavez in Venezuela makes it an anomaly in the region. And so in addition to just talking about it more, I'd like to sort of insert a discussion about the pipeline through Colombia which fits the pattern of Chinese behavior.

They obviously care about energy resources, not only at the source, but transporting them in a strategically sound way to the Chinese market. And given the dodgy border relationship between Venezuela and Colombia, to try to help me make sense of whether this is something that merits greater investigation and concern on our part? For everyone.

Mr. SANTOLI. Okay. There is that going on. It's oil in Venezuela, the fifth largest oil exporter to the United States. There is the issue of the sand oil in Peru and in a couple of other places that also if there is a crisis in the Middle East and we don't have access, all of this becomes exceptionally important to us.

But I would also say that if you're at the whole region for a consensus, whether people would rather be in an American sphere of influence or a Chinese sphere of influence, what matters is the key strategic countries, where we have to be concerned for our national security, and I would bring those back to the fore of Brazil, Venezuela, Cuba, and then because of the transit issue and because of the free port Panama.

That is the main concern. It's not a question of the level of economic numbers. It's not a question of if you took a vote among all Latin American countries, who's with us, who isn't. The key thing is of those areas that are unstable and pose a threat to the United States, what are we doing about it?

What are we doing to prevent any type of future sabotage or future conflict that could hurt the United States? That is the key issue.

Dr. WATSON. I use Colombia as an example of why I think that the Chinese are being extremely careful. What we are not seeing is we are not seeing a lot of evidence that China is engaging with the FARC. We are not seeing a lot of evidence frankly that the Chinese are engaging with the para-militaries. Again, I'm in a minority in this town, but my concern about Colombia, and I have studied Colombia for about 37 years, so I have a pretty good idea of what I'm talking about, Colombia's problems are not going to be resolved once you have the para-militaries demilitarized.

There are all sorts of problems Colombia has got to deal with. If I were looking for a place to engage in the region that I really wanted to get some mischief going, I would choose one of those two groups. They're not because it's not worth what would happen to them in terms of the relationship with Washington if they were to do that.

It's simply not worth it. So I think that what you see is that Beijing is acting, again, to use the word "judiciously." They are weigh-

ing what is important to them versus what they're going to get out of mischief in the region.

Commissioner DONNELLY. But is the pipeline at all viable in a politically unstable Colombia?

Dr. WATSON. I'm not positive that that pipeline is ever going to be viable because of the ELN. The ELN spends most of its time blowing up pipelines. That's what they do for a living. That's what they are very good at. In any 365 day period, the ELN makes an attempt to blow up the existing pipelines in Colombia, northeast Colombia, 300 days a year. So that's got its problems.

Commissioner DONNELLY. So the answer is no.

Dr. WATSON. Yes.

Commissioner DONNELLY. Yes.

Dr. WATSON. It's got its problems. What is I think more important down the line is whether Colombia does, in fact, resolve some of its problems and then walk away from its very close relationship right now with Washington. Part of that relationship is driven by its problems with Venezuela for good reason. But what then happens to Chinese interests in the potential of moving into Colombia? Do those interests go up or do Colombians say no, no, we are going to turn back to Washington and retain our close friendship?

I think that Mr. Loser's point, and I tried to make the same point, but it's absolutely crucial. It's not just that Latin America wants to be treated as not a pawn of one side or the other, but they wanted to be treated as a region or member states of a region where they will have some sort of treatment of equality and they don't see that happening right now. Beijing has proven a little more willing to say they'll go that way in this very public way even if they're not, in fact, doing it.

And that may be where the frustration grows even greater, but I don't know where they turn? To India after that. They're running out of places to turn.

Cochair BARTHOLOMEW. And finally Commissioner Becker.

Commissioner BECKER. Thank you. Very short question to Dr. Watson or anybody else if they want to add in. What is China's relationship or interest in the Panama Canal?

Dr. WATSON. Many people bring up the Panama Canal because of the Colon issue, because of both sides, and the Hutchison Whampoa involvement in the Canal. My answer on that is if China were really as interested in the Canal as some people fear, then the very first thing they would have done is push Panama to shift recognition from Taiwan to Beijing. They have not done that. They have proven fairly unsuccessful, like totally unsuccessful, at getting that shift.

Beijing, as you know as well I do, Beijing operates a lot of the time on questions that we might look at and say why are you worried about the press on this particular issue, but on the issue of a country that few—26 states—that still recognize Taiwan, that drives them crazy. One of the first things if not the first thing that they would do, if Panama were at the focus of their attention, is push Panama to shift, and they have not done that.

Commissioner BECKER. When we turned the Canal over to Panama, were there any residual rights of right of first refusal or anything in that agreement that allowed us to go back in?

Dr. WATSON. The answer to that question often comes down to who you ask. There are some people who read the agreement that there are rights that are still there.

Commissioner MULLOY. Isn't that the De Concini amendment?

Cochair BARTHOLOMEW. Mr. Santoli, you looked like you had a comment?

Mr. SANTOLI. Yes. I think the key thing with this is that treaty can be interpreted different ways. The Panamanians interpret it different ways in terms of their own sovereignty in the issue. The Panamanians were playing everybody off against everybody. For the Chinese, getting access through that Canal, it gave them credibility in the region in the mid-'90s that was economic and it was political, and it also—if you look at a parallel track, it's when a lot of the militaries in the Latin American region started doing military-to-military relationships to China.

If they had as Dr. Watson had said, if they had pushed Panama too hard on the Taiwan issue, that would have raised red flags in the United States and it still would raise red flags in the United States which they don't want, so they're backing off of that. What's more important to them with Panama and the ports is stevedoring. The control they do have is loading and offloading of ships through Hutchison Whampoa.

And in that regard, especially when we talk about a place like Colon where you've got such an involvement of intelligence agencies and organized crime from all over the world, dual-use technology transfers, moving stuff in, moving stuff out. That is a key strategic issue.

Secondly, the Chinese are masters of operating behind the scenes. For some of us that worked Afghanistan, through the early to mid to late 1990s, it drove us nuts because the Chinese were supporting the Paks and supporting the Saudis in backing the Taliban and Osama bin Laden. But they wouldn't do it up front. They did it through Pakistan.

In the same way, with the FARC, I don't know it. They won't do it—Colombia is too crazy for anybody to do something in right now. But they will operate whatever they're doing with Colombia through Chavez because Chavez and Cuba have good relationships with the FARC, and the lifeline for the FARC is Colon and Panama. At the same way, it's the lifeline for Cuba for it has been for a long time in terms of trade.

So you have to look at what they're doing behind the scenes. That's why when the Chinese say the American military doesn't understand us, because they look always at conventional, they looked at the predictable, we have to beat them where they least expect us, which is the shadow, the deception, and that's what they're doing.

Cochair BARTHOLOMEW. Dr. Watson, a closing word.

Dr. WATSON. I would just, I would differ with Mr. Santoli on the importance of Colon to the FARC. The FARC is making its money on drug trafficking as is most of Colombia and trade is irrelevant to the FARC. What matters to the FARC is now drug trafficking, which wasn't necessarily true 20 years ago.

But the other part I would just raise is when it comes to Panama, the PLA has divested from significant portions of the econ-

omy. I think it's quite credible the people that argue that the PLA have divested from Hutchison Whampoa. I'm not certain what the evidence is that they have not. Why is it that we are always so certain that the malicious side of Chinese behavior comes through?

I haven't been given, and I talk to a lot of people about this—I haven't been given a satisfactory answer on that. I realize you prepare for bad scenarios when you're the military. That doesn't mean as an analyst, you have to always prepare from the bad side as well.

Cochair BARTHOLOMEW. Thank you. Clearly, we've got some topics of dissent here. Thank you to all of our panelists for your providing us the benefit of your expertise and for your graciousness. We've gone significantly over when we had asked you to be here, but thank you very much, and we look forward to working with you all.

Thanks.

[Whereupon, at 4:50 p.m., the hearing adjourned, to reconvene at 9:07 a.m., Friday, July 22, 2005.]

CHINA'S GROWING GLOBAL INFLUENCE: OBJECTIVES AND STRATEGIES

FRIDAY, JULY 22, 2005

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION,
Washington, D.C.

The Commission met in Room 106, Dirksen Senate Office Building, Washington, D.C. at 9:07 a.m., Chairman C. Richard D'Amato, Vice Chairman Roger W. Robinson, Jr., and Commissioners Carolyn Bartholomew, June Teufel Dreyer and Michael R. Wessel (Hearing Cochairs), presiding.

OPENING REMARKS OF CHAIRMAN C. RICHARD D'AMATO

Chairman D'AMATO. The Commission will come to order. This is the second day in a two-day hearing on China's Growing Global Influence: Objectives and Strategies. Today we're going to be looking at China's approach to Europe, Northeast and Southeast Asia, as well as South Asia and the former Soviet states. We're biting off quite a bit here.

The Cochairwoman of today's hearing will be Commissioner June Dreyer to my right, and at this point I'd like to turn over the proceedings to Commissioner Dreyer.

OPENING STATEMENT OF COMMISSIONER JUNE TEUFEL DREYER HEARING COCHAIR

Cochair TEUFEL DREYER. Good morning ladies and gentlemen, and welcome to the second day of our hearings. We are very, very pleased to have such a distinguished group of panelists with us this morning. The problem that we're addressing is China's growing influence in, and ties to, various regions of the world, which have raised serious ties in the minds of U.S. policymakers including our clients, the United States Congress.

I would like to first introduce Dr. Christopher Dent, Senior Lecturer in the Department of East Asian Studies at the University of Leeds in the United Kingdom. We thank you especially for coming so far. Dr. Dent's research interests center on the international political economy of East Asia and East Asia's relations with the European Union.

Dr. Dent, I understand you have requested a couple of extra minutes, and that's available.

[The statement follows:]

Prepared Statement of Commissioner June Teufel Dreyer Hearing Cochair

Good morning and welcome to the second day of our hearing on *China's Growing Global Influence: Objectives and Strategies*. Yesterday we heard from a number of

witnesses, both from inside and outside government, regarding China's growing global influence and its energy policy.

Today we will continue to assess China's approach to certain regions, specifically Europe; Northeast, Southeast, and South Asia; and the successor states to the Soviet Union.

China's growing influence in and ties to these regions have raised serious concerns in the minds of U.S. policymakers. Today's panels will address these matters. For example, China's large purchases of weapons systems and arms from Russia have strategic implications not only for the U.S. but for other nations in close proximity to China as well. Some of these are part of America's alliance system; all are important for the maintenance of Asian stability.

The panels will also address important U.S. interests that are in play in China's relationships with countries in these regions. In South Asia, for example, it is important that we try to ensure that China's considerable influence with Pakistan is used to lessen rather than heighten regional tensions.

I now would like to begin today's portion of this hearing by welcoming Doctors Robin Niblett and Christopher Dent.

PANEL VI: CHINA'S APPROACH TO EUROPE

STATEMENT OF CHRISTOPHER M. DENT SENIOR LECTURER IN THE EAST ASIAN ECONOMY DEPARTMENT OF EAST ASIAN STUDIES UNIVERSITY OF LEEDS, UNITED KINGDOM

Dr. DENT. Yes.

Members of the Commission, I'd like to thank you for inviting me here today to talk about China's economic relationship with the European Union and its implications for the United States and the wider international community. In recent times, the European Union and China have talked increasingly of fostering a strategic partnership between them, this being primarily founded on their strengthening economic ties.

While the term "strategic" may set off certain political alarm bells here in Washington, I do not believe that the E.U.-China partnership is intended to directly challenge the U.S.'s position in the global economy or other domains. Rather, the main objective of this partnership is to build a key linkage in international society that amongst other things should lead to more effectively addressing the global economic challenges that face us all.

Let me briefly outline key developments in China-Europe economic exchange and diplomacy. For some time, Europe was the Cinderella trade partner to China, always lagging some way behind Japan and the United States.

This, though, is no longer the case. In 2002, the EU was China's third-most important trade partner. Now it is the most important trade partner according to China's Ministry of Commerce. Statistics from their ministry in 2004 stated that China imported US\$70 billion worth of goods from the European Union, this representing 12.5 percent of China's total imports.

This compared according to the same statistics, US\$45 billion of imports from the U.S. and US\$94 billion from Japan. Regarding China's export trade, China's exports to the European Union in 2004 came to US\$107 billion which was 18.1 percent of the total, which way behind the US\$125 billion worth of exports to the United States that year which represented 21.1 percent of the total.

And for Japan, China exported US\$74 billion worth of products. Putting these figures together, China-EU trade in 2004 according to the Ministry of Commerce in China totaled US\$177 billion.

China-U.S. trade came in close second with US\$170 billion, and Japan-China an even closer third at US\$168 billion.

While there is not much difference here between China's main trade partners, its trade volume growth with Europe has been fastest of the three. Our most recent figures for the first quarter of 2005 suggested the growth rate for EU-China trade is accelerating even faster, approaching at the moment about 25 to 30 percent per annum.

Moreover, China is now the EU's second-largest trade partner with the U.S. still remaining the largest. In 1980, China accounted for 0.7 percent of EU imports and 0.9 percent of EU exports. By 2004, these shares had risen to 12 percent and five percent respectively.

The EU's trade with China has well over doubled in the last five years making it Europe's most dynamic trade partner by far.

European firms have also invested heavily in China with an accumulative total of foreign direct investment, of FDI, at about US\$60 billion by 2003. This represented 21 percent of all FDI stock in China if Taiwan and Hong Kong FDI is factored out, and this compared by the same basis to the U.S.'s 24 percent and Japan's 22 percent.

While Europe remains in third place here on FDI, its share has increased at a much faster rate. In 1996, Europe's share was 14 percent; the U.S.'s 22 percent, and Japan's 17 percent.

In finance, too, China has showed a recent preference for holding euros over dollars in its expanding foreign exchange reserve portfolio that is approaching US\$800 billion, the second largest in the world after Japan.

This has further strengthened China's stake in the European Union economy. At the inter-societal level, increasing numbers of Chinese students are coming to study at Europe's schools, colleges, universities, especially to the UK which attracts around half of the approximately 100,000 Chinese students attending Europe's colleges and universities.

The U.S. has remained the preferred destination for Chinese students, but this may be changing with recent U.S. visa restrictions placed on Chinese students and others.

This growth in human contact or socialization between the EU and China provides an important micro-level underpinning of EU-China economic relations, but of course this is similarly the case for U.S.-China economic relations.

The substantive deepening of economic ties parallels an ever-closer economic diplomacy between the EU and China has been matched by deeper economic diplomacy. Trade and cooperation agreements were first signed in the late 1970s and 1980s. Although high-level economic diplomacy cooled in the aftermath of the 1989 Tiananmen Square massacre, it advanced again by the mid-1990s, marked by the publication in 1995 of a European Commission document entitled "A Long-Term Policy for China-Europe Relations." This outlined the EU's intent to move beyond its past approach of largely trying to contain the economic competitive threats posed by China to an approach that emphasized a broader economic and diplomatic engagement. Key elements of this were to encourage and to support China's integration into international structures

such as the World Trade Organization and the multilateral trading system.

The idea was and remains to deepen China's sense of international citizenship, which in theory should make it a more predictable and responsible member of the global community.

Subsequent European Commission policy papers further articulated this intended shift from containment to engagement such as the 1998 Building a Comprehensive Partnership with China document and more recently the 2003 document entitled "A Maturing Partnership: Shared Interests and Challenges in EU-China Relations."

In this year, China also published its own paper on its Europe policy. And these documents have helped further define the interests and goals of the emerging strategic economic partnership between China and the EU.

At the December 2004 EU-China Summit, the two parties agreed to add new layers of economic cooperation between them, signing a raft of albeit relatively low funded cooperation programs. For example, on managers exchange and training, information society and research and development.

At the inter-regional level, the EU has worked together with China and other East Asian countries since 1996 within the Asia-Europe Meeting Framework, of ASEM, which has sought to cultivate closer economic, political and social cultural ties between both regions.

The major EU member states also meet with China at the G8 meetings, China being, in effect, an associate member of the group. Diplomatic engagement between the EU and China at the global multilateral level is also deepening, particularly after China's accession to the WTO in 2001. Taken together, these expanded points of diplomatic contact have provided new opportunities for the European Union and China to discuss economic and other matters and further develop the basis of their strategic partnership.

Thus far, I've framed China-EU economic relations in the positive terms of general growth and development. But there are, of course, significant competitive challenges that China poses to the EU economy. These are broadly similar to those that face the United States as illustrated by recent textile trade disputes with China.

The EU and China have come to a resolution on this particular issue, but Beijing and Washington have yet to reach an agreement. In other areas, the EU still applies a number of anti-dumping duties on Chinese products such as bicycles and has expressed concern over China's managed exchange rates policy, although not as vehemently or as persistently as the United States have done, and of course we saw only yesterday a relaxation in that exchange rate policy from China, and this has been welcomed both by the EU and the U.S.

China's difficult regulatory environments and lax commercial laws continue to frustrate European, American and other foreign investment firms alike, although the Chinese are making some progress on improving the situation.

Corruption levels while still comparatively high by broad international standards are reported to be falling significantly. The com-

mercial legal environment is improving too, partly out of intensified competition between provincial governments to attract foreign investment.

Both the European Union and the United States are encouraging China to accelerate the pace of economic reform and further progress should be expected given that China is committed to further opening up its economy, strengthen certain areas of commercial law under the terms of its WTO accession.

Overall, though, the European Union's problems with China's commerce are generally less acute and less complicated than when compared to the United States' own problems. Less acute because the EU's trade deficit has generally been around half of that that the U.S. has with the country, and less complicated because the EU's economic relations with China are largely unencumbered by national security issues, an important matter for discussion which I will return in a moment.

The European Union is, though, still concerned about its trade imbalances with China and the negative impacts that highly competitive Chinese imports are having upon European industries. The European Commission, national European governments and the EU business associations are assiduously examining these manifest impacts. And the EU may again apply transition or safeguard mechanisms on Chinese imports other than textiles.

It is difficult to gauge the extent to which the European Union will react in a protectionist manner towards China trade competition, but it's probably safe to say that not to the same degree as being contemplated here in the United States.

While then the EU is taking these competitive challenges and contentious issues seriously, the China threat does not resonate in Europe the same way that it does in the United States. Regarding matters of commerce, chief economists around Europe tend to see the dynamic Chinese economy more in terms of an opportunity than a threat, but of course commerce is only one part of the economic diplomacy equation.

A key reason why Europe-China economic relations have prospered is that they are not burdened with the same national security concerns as U.S.-China economic relations appear to be.

There have been no bids from Chinese companies to acquire perceived strategic commercial assets in Europe, as has recently been the case in the U.S. More generally, the fact that the European Union has virtually no security responsibilities in East Asia allows Europe and China to cultivate their economic relationship unhindered by security related distractions and tensions.

Although the European Union has at times sought to press Beijing over sensitive matters like human rights and the rule of law, China is not generally seen as a potential enemy. This has helped the EU-China economic relationship advance in key areas over and above that which is currently possible in U.S.-China economic relations, as recently illustrated in the field of space technology collaboration.

American and Chinese cooperation in this sector has effectively ended since the U.S. tightened its regulations in 1998 on illegal missile technology transfers that subsequently led to the classifica-

tion of space technology on the U.S. State Department's munitions list.

Meanwhile, Europe has significantly enhanced its space technology cooperation with China. Since October 2003, China has worked with the EU in developing Europe's Galileo satellite navigation system, an emerging rival to the U.S.'s own global positioning system, or GPS.

Many other avenues of high tech cooperation between the U.S. and China are most likely to be closed off due to various security sensitive restrictions. Yet, China and Europe do not generally face such constraints.

China's economic relations with the EU also appear less encumbered by ideology than U.S.-China relations. Professor Feng Zhongping, the Director of the European Studies Program at China's Institute of Contemporary International Relations in Beijing, recently commented that a lot of European countries want to support and encourage China's development while the Americans want to influence the direction of its development.

American missionary zeal to convert China into democratized market-oriented society is far stronger than Europe's. There are complex social, political and historic reasons for this that relates perhaps more to the U.S.'s perceived role in the world than Europe's own less defined role.

In sum, the EU has been able and willing to take a pragmatic approach to its economic relations with China and this seems to have spurred their development as recent trade data, investment data and other economic indicators suggest.

The EU and U.S.'s bilateral problems and contentious issues with China must be managed accordingly, but equally so most economic partnership and cooperation with her be promoted. For both the European Union and United States, cultivating positive relations with big emerging developing countries like China will be of critical importance as this century unfolds.

The EU, China and the U.S. all face the same major global economic security challenges such as energy and food security, poverty alleviation, and moving towards a more eco-sustainable development paradigm.

Effectively addressing these global economic issues requires the cultivation of positive and harmonious international economic relations at various levels. In the WTO, China appears not just to be championing developing country interests in coalition with other emerging powers like India and Brazil, but also seeking to build bridges between the developing and developed countries within the Doha Round of global trade talks.

Some may argue such maneuvers are intended to gradually strengthen China's structural power within multilateral organizations. That is to develop capabilities to shape the rules of the game by which all other nations must abide.

However, the prevailing European view is that it is better to work with China in various multilateral frameworks and work constructively alongside her than engage in confrontational standoffs.

Having said this, the European Union or more specifically particularly EU member states need to make far greater concessions

on agricultural trade liberalization at this stage of the Doha Round if it is to build more constructive partnership with China and developing country trade partners in general.

The same too, of course, applies to the United States. It is my view that the multilateral dimensions that China, EU and U.S. economic diplomacy will become of increasing importance over forthcoming years and decades. China's accession to the WTO has been a crucial step forward in deepening the country's sense of international citizenship and multilateral responsibility in keeping with the aforementioned EU objective of integrating China into international structures.

In the past, China was wary of multilateral institutions and mechanisms at both the regional and global level. Many of the Chinese elite perceived multilateral economic organizations as more or less extensions of American foreign economic policy or as essentially serving broader Western interests.

However, a more positive view towards multilateralism has been in the ascendant amongst Beijing's policymakers for a while now mainly because it sees the WTO, IMF, World Bank and so on as the ultimate custodians of the international economic system on which China is flourishing.

It is thus in China's own interests to support the development of these organizations to avert further systemic disturbances to the global economy on which the country increasingly depends.

I, of course, accept that China will become a significant competitor to the United States and the European Union, and there are inherent risks and threats borne with therein to the U.S. and EU economies. By the same token, China's ascendancy has already proved to provide considerable economic benefits to the EU and the U.S.

The scope for cultivating economic relationships or partnerships with China is broadening all the time. As EU Trade Chief Peter Mandelson remarked earlier this year with respect to China, "We won't be trading airbuses for t-shirts for much longer," and that "competition and partnership can go hand in hand."

Just finally to conclude, the U.S. and EU's shared past experience of addressing the Japan threat from the 1980s showed that a rising high tech competitor can also provide opportunities for high value added cooperation between firms from different regions.

Moreover, regarding the highly geopoliticized issue of oil supply security, it is imperative for China, Europe and the U.S. to work towards a mutual reduction of oil dependency as well as promote cooperation on developing renewable energy technologies and achieving greater fuel efficiency.

While this may sound idealistic, what is the alternative? Intensifying adversarial competition for natural resources that could lead to open military conflict. China, Europe and the U.S. owe it to themselves and the rest of international society to find peaceful solutions to these common problems based on the mind-set of cooperation, partnership and trust.

Thank you.

[The statement follows:]

**Prepared Statement of Christopher M. Dent
Senior Lecturer in the East Asian Economy
Department of East Asian Studies, University of Leeds, United Kingdom**

China's Economic Relationship With the European Union

1. Opening Comments

Members of the Commission, ladies and gentlemen, I would like to thank you for inviting me here today to talk about China's economic relations with the European Union and its implications for the United States and the wider international community. In recent times the European Union and China have talked increasingly of fostering a "strategic partnership" between them, this being primarily founded on their strengthening economic ties. While the term "strategic" may set off certain political alarm bells here in Washington, I do not believe the EU-China partnership is intended to directly challenge the U.S.'s position in the global economy or other domains. Rather, the main objective of this partnership is to build up a key linkage in international society that, amongst other things, should lead to more effectively addressing common global economic challenges that face us all.

2. China-Europe: Economic Exchange and Diplomacy

Economic Exchange

For some time, Europe was the "Cinderella" trade partner to China, always lagging some way behind Japan and the United States. This, though, is no longer the case. In 2002, the EU was China's third most important trade partner but by 2004 Europe had become the most important according to statistics from China's Ministry of Commerce:

- *China's import trade:* In 2004, China imported \$70 billion worth of goods from the European Union, this representing 12.5 percent of China's total imports. This compared to \$45 billion of imports from the U.S. (8.0 percent of total), and \$94 billion from Japan, China's biggest single source of imports (16.0 percent of total).
- *China's export trade:* China's exports to the EU in 2004 meanwhile came to \$107 billion (18.1 percent of the total), which was some way below the \$125 billion worth of exports dispatched to the U.S. that year (21.1 percent of total) but above the \$74 billion figure for Japan (12.4 percent of total).
- *Total trade:* Putting these figures together, China-EU trade in 2004 totaled \$177 billion, China-U.S. trade a close second at \$170 billion, and China-Japan trade an even closer third at \$168 billion. While there is, then, not much difference here between China's main trade partners, its trade volume growth with Europe has been the fastest of the three, and most recent figures for the first quarter of 2005 suggest that the growth rate for EU-China trade is currently accelerating faster than for any other major trade partner, at approaching 25 to 30 percent per annum.

EU trade and China: Moreover, China is now the EU's second largest trade partner, the U.S. still remaining the largest. In 1980, China accounted for only 0.7 percent of EU imports and 0.9 percent of EU exports. By 2004 these shares had risen to 12 percent and 5 percent respectively. The EU's trade with China has well over doubled over the last five years, making it Europe's most dynamic major trade partner by far.

Europe's investment position in China: European firms have also invested heavily in China with the accumulative total of foreign direct investment, or FDI, from the EU reaching \$60 billion by 2003. This represented 21 percent of all inward FDI stock in China if FDI from Hong Kong and Taiwan is factored out, which compares to the U.S.'s 24 percent and Japan's 22 percent. While Europe remains in third place, its share has increased at a much faster rate: in 1996 the EU's share was 14 percent, the U.S.'s 22 percent and Japan's 17 percent.

China and the euro: In finance, China has recently showed a preference for euros over dollars in its expanding foreign exchange reserve portfolio, that at around \$800 billion in total is the second largest in the world after Japan. This has further strengthened China's stake in the European Union economy.

Education and tourism: At the inter-societal level, increasing numbers of Chinese students are coming to study at Europe's schools, colleges and universities, especially to the UK, which attracts the second highest number of Chinese university students in the world after the United States. With rising incomes and high social value afforded to education, the EU can expect to see many more Chinese nationals attending European universities, although the preferred destination still remains the United States. This growth in human contact or "socialisation" between EU and

Chinese nationals provides an important micro-level underpinning the EU-China economic relations, as is similarly the case for U.S.-China economic relations.

Economic Diplomacy

The substantive deepening of economic ties has been paralleled by an ever closer economic diplomacy between the EU and China. Trade and cooperation agreements were first signed in the late 1970s and mid-1980s. Although high-level economic diplomacy cooled in the aftermath of the 1989 Tiananmen Square massacre, it had advanced again by the mid-1990s, marked by the publication in 1995 of a European Commission policy document entitled *A Long-Term Policy for China-Europe Relations*. This outlined the EU's intent to move beyond its past approach of mainly trying to *contain* the competitive threats posed by China (for example, by using the blunt instrument of anti-dumping duties on various Chinese imports) to an approach that emphasised a broader economic and diplomatic *engagement*. A key element of this was to encourage and support China's integration into "international structures," such as the World Trade Organisation (WTO) and the multilateral trading system. The idea was, and remains, to deepen China's sense of international citizenship, which in theory should make it a more predictable and responsible member of the global community.

Subsequent European Commission policy papers further articulated this intended shift from containment to engagement, such as the 1998 *Building a Comprehensive Partnership with China* document, and more recently the 2003 document entitled *A Maturing Partnership: Shared Interests and Challenges in EU-China Relations*. These have helped define the interests and goals of the emerging strategic economic partnership between China and the EU, at least from Europe's perspective. At the December 2004 EU-China Summit, the two parties agreed to add new layers of economic cooperation between them by signing a raft of (albeit relatively low-funded) cooperation programmes, for example on managers exchange and training, information society, and research and development.

At the inter-regional level, the EU has worked together with China and other East Asian countries since 1996 within the Asia-Europe Meeting framework, or ASEM, which has sought to cultivate closer economic, political and socio-cultural ties between both regions. The major EU member states also meet with China at the G-8 meetings, China being in effect an associate member of the Group. Diplomatic engagement between the EU and China at the global-multilateral level is also deepening, particularly after China's accession to the WTO in 2001. Taken together, these expanding points of diplomatic contact have provided new opportunities for the European Union and China to discuss economic and other matters, and further develop the basis of their strategic partnership.

3. Challenges and Contentious Issues

Thus far I have framed China-EU economic relations in positive terms of general growth and development. There are, of course, significant competitive challenges that China poses to the European Union economy. These are broadly similar to those that face the United States, as illustrated by recent textile trade disputes with China. The EU and China have come to a resolution on this particular issue but Washington and Beijing have yet to reach an agreement. In other areas, the EU still applies a number of anti-dumping duties on Chinese imports, for example on bicycles, and has expressed its concern over China's managed exchange rate regime, although not as vehemently or as persistently as the United States has done. While EU Trade Commissioner, Peter Mandelson, recently commented that China "must not stick to an artificially low exchange rate as part of a strategic trade policy, or fix prices below long-term sustainable costs," he also conceded that the European textiles industry "will need to adjust because, ultimately, our responsibility is to compete" [*International Herald Tribune*, 09.04.2005].

China's difficult regulatory environment and lax commercial laws continue to frustrate European, American and other foreign investing firms alike, although the Chinese are making some progress at improving the situation. Corruption levels, while still comparatively high by broad international standards, are reported to be falling significantly. The commercial legal environment is improving too, partly out of intensified competition between provincial governments to attract foreign investment ["Country Profile Report on China: 2004" *Economist Intelligence Unit*, 2005]. Both the European Union and the United States are encouraging China to accelerate the pace of economic reform. Further progress should be expected given that China is committed to further open up its economy and strengthen certain areas of commercial law under the terms of its WTO accession.

Overall, though, the European Union's problems with China's commerce are generally less acute and less complicated when compared to the U.S.'s own problems:

less acute because the EU's trade deficit with China has always been around half of the U.S.'s own deficit with the country (in 2004, \$37 billion compared to \$80 billion respectively), and *less complicated* because the EU's economic relations with China are largely unencumbered by national security issues, an important matter for discussion which I shall return to in a moment.

The European Union is, though, still concerned about its trade imbalances with China and the negative impacts that highly competitive Chinese imports are having upon European industries. The European Commission, national European governments and Europe's business associations are assiduously examining these manifest impacts, and the EU may again apply "transitional safeguard mechanisms" on Chinese imports other than textiles. The Commission will probably already know that, under the terms of China's WTO accession, these measures may be utilised where surges of Chinese imports are deemed to cause, or threaten to cause market disruption to other WTO members during a 12-year period from the date of accession. It is difficult to gauge the extent to which the European Union will react in a protectionist manner towards Chinese trade competition, but it is probably safe to say not to the same degree as is being contemplated here in the United States.

The EU is likely, however, to soon "graduate" China from its Generalised System of Preferences (GSP) scheme—under which the EU grants autonomous trade preferences to imports from developing countries—on the grounds that the country's export profile has grown so strong. China is currently the main beneficiary of the European Union's GSP scheme with a share of more than 30 percent of all qualified preferential imports. Beijing is unlikely to object to GSP graduation given its burgeoning trade surplus with the EU.

4. China: Security Threat or Commercial Opportunity?

While, then, the EU is taking these competitive challenges and contentious issues seriously, the "China threat" does not resonate in Europe in the same way that it does in the United States. Regarding matters of commerce, chief economists around Europe tend to see the dynamic Chinese economy more as an opportunity than a threat, but commerce is not the only part of the economic diplomacy equation. A key reason why Europe-China economic relations have prospered is that they are not burdened with the same national security concerns as U.S.-China economic relations appear to be. There have been no bids from Chinese companies to acquire perceived strategic commercial assets in Europe, as has recently been the case in the United States, such as Lenovo's acquisition of IBM's personal computer division and CNOOC's current attempts to acquire Unocal. More generally, the fact that the European Union has virtually no security responsibilities in East Asia allows Europe and China to cultivate their economic relationship unhindered by the security-related distractions and tensions that seem to beset the U.S.-China economic relationship.

Although the European Union has at times sought to press Beijing on other sensitive matters like human rights and the rule of law, China is generally not seen as a potential enemy to Europe. This has helped the EU-China economic relationship advance in certain key areas over and above what is currently possible in U.S.-China economic relations, as recently illustrated in the field of space technology collaboration. American and Chinese cooperation in this sector has effectively ended since the U.S. tightened its regulations in 1998 on illegal missile technology transfers that subsequently led to the classification of space technology on the U.S. State Department's munitions list. Meanwhile, Europe has significantly enhanced its space technology cooperation with China. Since October 2003, China has worked with the EU in developing Europe's *Galileo* satellite navigation system, an emerging rival to the U.S.'s own Global Positioning System, or GPS. Many other avenues of high-tech cooperation between the U.S. and China are most likely closed off due to various security-sensitive restrictions, yet China and Europe do not generally face such constraints.

China's economic relations with the European Union also appear less encumbered by ideology than are U.S.-China relations. Professor Feng Zhong-ping, Director of European Studies at China's Institute of Contemporary International Relations in Beijing, recently commented that, "a lot of European countries want to support and encourage China's development, while the Americans want to influence the direction of its development" [*Wall Street Journal*, 13.06.2005]. American missionary zeal to convert China into a democratised, market-oriented society is far stronger than Europe's. There are complex social, political and historic reasons for this that relate perhaps more to the U.S.'s perceived role in the world than Europe's own less well-defined role. In sum, the EU has been both able and willing to take a pragmatic approach towards its economic relations with China, and this seems to have spurred

their development as recent data on trade, investment and other economic indicators suggest.

It may also be instructive to cite the comments from China's Trade Minister, Bo Xi-lai, made after resolving his country's textiles trade dispute with the EU in June 2005. Bo stated that, "Unlike some other countries, the EU didn't take unilateral steps against China but discussed the issue in a friendly manner. The Chinese people have a saying: if you respect me by an inch, I'll respect you by a foot" [*Wall Street Journal*, 13.06.2005]. Whatever interpretation you take on this thinly veiled jab at the United States on this issue, it reveals how Beijing currently views its bilateral economic diplomacy with the U.S. in more problematic terms in comparison to that with the European Union.

5. Common Economic Security and Global Interests

The EU and U.S.'s bilateral problems and contentious issues with China must be managed accordingly but equally so must economic partnership and cooperation with her be promoted. For both the European Union and United States, cultivating positive relations with big emerging developing countries like China will be of critical importance as this century unfolds. The EU, U.S. and China all three face the same major global economic security challenges, such as energy and food security, poverty alleviation and moving towards a more eco-sustainable development paradigm. Effectively addressing these global economic issues requires the cultivation of positive and harmonious international economic relations at various levels.

In the WTO, China appears to be not just championing developing country interests in coalition with other emerging powers like India and Brazil, but also seeking to build bridges between developing and developed countries within the Doha Round of global trade talks. Some may argue such manoeuvres are intended to gradually strengthen China's structural power within multilateral organisations: that is to develop capabilities to shape the rules of the game by which all other nations must abide. However, the prevailing European view is that it is better to bring China into various multilateral frameworks and work constructively alongside her rather than engage in confrontational standoffs. Having said this, the European Union—or more specifically particular EU member states—need to make far greater concessions on agricultural trade liberalisation at this stage of the Doha Round if it is to build a more constructive partnership with China and developing country trade partners in general. The same too applies for the United States.

It is my view that the multilateral dimension to China, EU and U.S. economic diplomacy will become of increasing importance over forthcoming years and decades. China's accession to the WTO has been a crucial step forward in deepening the country's sense of international citizenship and multilateral responsibility, in keeping with the aforementioned EU objective of integrating China into "international structures." In the past, China was wary of multilateral institutions and mechanisms, whether at a regional or global level. Many of the Chinese elite perceived multilateral economic organisations as more or less extensions of American foreign economic policy, or as essentially serving broader Western interests. However, a more positive view towards multilateralism has been in the ascendant amongst Beijing's policymakers for a while now, mainly because it sees the WTO, IMF, World Bank and so on as the ultimate custodians of the international economic system in which China is flourishing. It is thus in China's own interests to support the development of these organisations, and work with others multilaterally to avert future systemic disturbances to the global economy on which the country increasingly depends.

I'm not going to speculate about the exact extent to which the Chinese worldview has shifted beyond Sino-centrism and its traditional belief in a hierarchical world order that has previously narrowed China's scope for multilateralist thinking. But China now exists, like other nations, in a very different globalising world and the Chinese are pragmatists. For a communist country to embark on a sustained programme of capitalist-based economic reforms over almost 30 years clearly shows this.

China knows full well that her rising power is based on economic growth, a growth that is significantly founded on international trade and investment. Moreover, the economic fortunes of China, Europe and the U.S. are based on increasingly interdependent connections with each other and others. American and European consumers buy cost-efficient (and thereby inflation-resistant) produced goods from China—a high percentage of these being exported from U.S. and EU firms based there—that in turn generates the surpluses for China to act as part creditor for the debt-laden United States and European Union economies. To date, China has purchased more than \$230 billion worth of U.S. Government securities, and a substantial but unestimated amount of European government debt (*Financial Times*,

18.07.2005). China, Europe and the U.S. are *de facto* “strategic partners” in today’s global economy whether they like it or not, such has the degree of economic interdependence that now exists between them, and economic partners as globally significant as themselves need to work together, particularly at the multilateral level because this encompasses the wider international community. They must avoid a descent into the kind of confrontational relations that have in the past precipitated major conflicts between great powers.

I of course accept that China has become a significant economic competitor to the United States and European Union, and there are inherent risks and threats borne therein to the U.S. and EU economies. By the same token, China’s ascendancy has already provided considerable economic benefits to the U.S. and EU, as previously noted, and the scope for cultivating economic relationships or partnerships with China is broadening all the time. As EU trade chief Peter Mandelson remarked earlier this year with respect to China, “We won’t be trading Airbuses for t-shirts for much longer,” and that, “competition and partnership can go hand in hand” [*International Herald Tribune*, 09.04.2005].

The U.S. and EU’s shared past experience of addressing the “Japan threat” from the 1980s showed that with a rising high-tech competitor also come greater opportunities for high-tech cooperation between firms from different regions. Moreover, on the highly geo-politicised issue of oil supply security, it is imperative for China, Europe and the U.S. to work towards a mutual reduction of oil dependency, as well as promote multilateral cooperation on developing renewable energy technologies and achieving greater fuel efficiency. While this may sound idealistic, what is the alternative? Intensifying adversarial competition for natural resources that could lead to open military conflict? China, Europe and the U.S. owe it to themselves and the rest of international society to find peaceful solutions to these common problems based on the mindset of cooperation, partnership and trust.

Thank you.

Cochair TEUFEL DREYER. Thank you very much, Dr. Dent. Now, Dr. Robin Niblett who is the Executive Vice President and the Director of the European Program at the Center for Strategic and International Studies here in Washington. Dr. Niblett is responsible for overseeing all aspects of the Center’s management and performance. He is a specialist on the transatlantic alliance and is the author of many books and reports and articles on the relationship between the United States and Europe and also on European political developments.

Welcome, Dr. Niblett. I think this is your second appearance here. Thank you.

**STATEMENT OF ROBIN NIBLETT
EXECUTIVE VICE PRESIDENT AND
DIRECTOR OF THE EUROPE PROGRAM
CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES
WASHINGTON, D.C.**

Dr. NIBLETT. Thank you very much. Thank you, Chairman, thank you, Commissioners for this opportunity to talk to you about the transatlantic relationship and how it’s been affected by China.

Secondly, may I apologize for not having my written statement in advance of this meeting. I think hopefully you have copies of it now.

Cochair TEUFEL DREYER. Yes.

Dr. NIBLETT. I will provide a synopsis in my oral statement right now of my written statement, and actually try and touch on a couple of the other questions that you addressed to me in your letter of invitation.

Let me start by saying right from the outset that inserting China into the transatlantic relationship is badly timed. Obviously we’re at a stage right now where the transatlantic relationship is still going through the birth pangs of a post-Cold War relationship, still

trying to understand how to recalibrate that relationship, and the rise of China alongside the rise of international terrorism has raised another large challenge for the transatlantic relationship.

I understand that the Commission is particularly interested in understanding whether the rise of China might give rise to a multi-polar world order within the context of an EU-China-U.S. relationship and whether Beijing is particularly trying to pursue that and whether the EU is open to such an outcome, and I will tackle that as my first point.

As my second point, I want to talk a little bit more about what the EU means by its strategic partnership with China and how again that might affect the transatlantic relationship.

There's little doubt in my mind that, from a Chinese perspective, creating a multi-polar world order and using the relationship with the EU to create it is an objective of Chinese policy. I am not a China expert. I am more of a Europe expert, but it strikes me that this would be a continuation of Chinese behavior over its history, certainly its history since it achieved full independence.

In the 1950s, and just as the United States in the 1950s was the source of Chinese concern and it tilted towards Russia, then when Russia became the source of concern, it tilted back toward the United States. Now the United States is a source of concern again, but this time China is tilting towards the EU and perhaps trying to find in the EU a way of balancing U.S. power and a way of trying to achieve greater flexibility in the management of its own domestic development and its international policy.

You could potentially see why China might believe that this would be a successful strategy. Certainly, we're all aware of elements of nervousness amongst the European political class and also amongst the European public about an unfettered United States after the Cold War predominant in military, economic power and seemingly—to use the jargon—acting in a “unilateral” way on the world stage.

There certainly seems to have been some resistance to that in European capitals and therefore one might make the leap over into believing that a multi-polar world order might be an alternative to U.S. hegemony for some European leaders.

There is also little doubt that President Jacques Chirac of France has fed that impression with his fairly explicit comments in favor, seemingly at least, of a multi-polar world in which the EU, China, the United States and Russia and India would all be balancing powers.

However, I think I'd like to demystify (I suppose this is the right word) this perception for three reasons. First of all, I don't think that Beijing is going to find in Europe a partner for a multi-polar world order. Despite the very close relationships that have been developed and which Dr. Dent has referenced in his comments, the differences in values, in norms and in objectives between Europe and China are fundamental and deep and they include, as you well know, attitudes to the rule of law, to corruption, to human rights, to the management of the economy, and also to the use of force.

And ultimately, the relationship that Europe is trying to develop with China is one that seeks to change China and not change Europe, and we're very much at the opening stage of that process, and

therefore the idea that somehow this shared objective of Chinese search for a balancing capability and EU's search for a more modern China could lead into a multi-polar alliance I think is premature at best and hopefully not going to be the case.

Secondly, my perception of European discussion of a multi-polar world order is one that is more descriptive than prescriptive. And I think you can take that across the board and perhaps even include some of the French perspectives in this view.

In other words, the world is moving toward an environment in which there are multiple poles of power. This is a reality, would be the European perspective, not necessarily one that is sought out, and this brings me to my third point. If there any part of the world that has suffered from a multi-polar approach to world order, it would be Europe with two world wars partly derived initially from the European theater and brought about very much through an inability to balance competing centers of power.

So from my perspective, the idea of a multi-polar world order being the vision that the EU is pushing, I think is not the case and is not true. However, the EU clearly does have a view of wanting to push a multilateral system of world order, and it's the multilateralism that I think is the source of the potential difference and interest in this triangular relationship because both the United States and China, I think, will resist the EU's push towards a multilateral option for world order, one that is borne out of Europe's own experience over the success of a multilateral approach to its own stability and order of the last 50 years.

The Chinese, for their part, have no interest in diluting or pooling their sovereignty, much as the EU has done, into larger multilateral institutions. So I suppose there is a game and a dance taking place right now where China's pursuit for some way of balancing U.S. power and EU desire to engage in China as a reality of its growing role in the world stage are giving this impression of a multi-polar and a multilateral world being brought together.

The second point I want to make quickly and I think I have about two minutes left—am I right in saying that—

Cochair TEUFEL DREYER. 29 seconds.

Dr. NIBLETT. 29 seconds. There you go. Very quickly in 29 seconds then, the strategic relationship and the strategic partnership, however, is one that is real and I think that it is driven partly by the economic drivers that Christopher Dent referred to, but also by a much deeper sense amongst European leaders that China is the source and the potential resolution to a number of the world challenges that we face whether it be environmental, proliferation of weapons of mass destruction, global health epidemics, environmental degradation.

If you take each of those challenges that the United States or European countries face in the future, you can see that China is part of the solution and part of the problem, and the EU would very much like to be able to confront it. What this leads us to then in conclusion is perhaps right now there is an opportunity for the United States and the EU to try to balance and coordinate their respective policies towards China.

Clearly, the U.S. approaches China from a very different prism. It separates the economic from the political. It sees economic inte-

gration, not necessarily leading to political reform in China. The Europeans, I think, have a very different view. They believe because of their own experience that the extension of the economic and the political linkages will lead inevitably to a greater source of security and stability over time.

The U.S. has traditionally had China and East Asia as its backyard for its foreign policy. It has not been part of the EU's backyard for its foreign policy. And the United States is having to learn how in essence to conduct a triangular foreign policy towards China as opposed to a bilateral policy and that is clearly causing strains and risks. It's an educational process I'd say for both sides and one that as we discussed in the last meeting really came to a head over the issues of the EU arms embargo.

So I would say at this moment, at a moment of flux, it's an opportunity for the U.S. and EU to try to coordinate, perhaps not explicitly but certainly actively, their policies to seek a balance of incentives and disincentives that they can each bring to their relationship with China. Because ultimately both the United States and the EU have an interest in a stable and ideally over time hopefully a democratic China emerging.

Thank you very much.
[The statement follows:]

**Prepared Statement of Robin Niblett
Executive Vice President and Director of the Europe Program
Center for Strategic and International Studies, Washington, D.C.**

China, the EU, and the Transatlantic Alliance

I. Introduction

Members of the Commission, thank you for inviting me to speak with you today concerning the possible effects of the deepening relationship between the European Union (EU) and China on the transatlantic alliance. The rise of China in recent years as a global economic power, as a dominant power in Asian security, and as an increasingly significant force in international diplomacy adds a further complicating dynamic to a transatlantic relationship that has yet to come to terms with the end of the Cold War or the best ways to confront the new dangers of international terrorism.

2004 was a year of transatlantic misunderstandings over China. For the rest of this year and into the next, U.S. and European policymakers must make a concerted effort to explain and listen to their respective fears, ambitions, and priorities about China. Only through an enhanced public and intergovernmental transatlantic dialogue on China and security in East Asia can each side start to coordinate their policies in ways that will be constructive rather than conflictual. This and other hearings that the Commission has held can play an important part in this process.

In this written statement, I will address briefly two key questions that the Commission Cochairs posed to me: (1) What role does Beijing envision for Europe in its hopes for a multi-polar world?, and (2) What are the implications for the transatlantic alliance of China's "strategic partnership" with the EU?

Let me note at the outset that I approach these questions from my position as Director of the CSIS Europe Program and of the CSIS Initiative for a Renewed Transatlantic Partnership, rather than as a student of Chinese policy. In addition, I will touch only briefly on the EU-China economic relationship which Dr. Dent covers in detail in his presentation.

II. Beijing's Hopes for Europe in a Multi-polar World

There is little doubt that China's current leaders would like to draw Europe and the EU into a multi-polar world order in which the transatlantic alliance would be weakened and in which China's ability to maneuver between Washington, Brussels, and EU member state capitals (as well as between Moscow, Delhi, and other key capitals) on its policy priorities would be maximized. From a zero-sum perspective, a weakening of the transatlantic bond would be a net plus in terms of the Chinese government's freedom of action domestically and on the world stage. This is nothing

new. China has a long history of wanting to “triangulate” between global power centers and thus lessen the strength of the dominant power that appears most threatening to its interests—this being the United States in the 1950s and 1960s and then the Soviet Union in the 1970s, when the Sino-American rapprochement took place. Now, at the start of the 21st century, Chinese leaders once again look to balance America’s predominant power and see the EU as a potential balancer.

You can see why China might hold out hope for such a strategic objective. A number of European leaders have expressed concern since the end of the Cold War over growing U.S. hegemony and a U.S. willingness to apply its power unilaterally, now that the United States appears unencumbered by the need for allies that characterized its strategic policy during the Cold War standoff with the Soviet Union. France’s President Jacques Chirac has gone further, speaking openly of his vision of the rise of a multi-polar world order over the coming decades, in which the United States, the EU, China, India, and Russia would constitute the dominant poles of power.

However, Beijing is likely to be disappointed if it believes that it can find in the European Union a partner with which to construct a new multi-polar world order. There are three principal reasons. First, European relations with China, despite their growing intensity at the economic and political levels, are still beset by fundamental differences in values concerning domestic and international governance. These differences include China’s commitment to democratic institutions, the rule of law, protection of human rights and minority rights, and the use of force. The recent intense debate within the EU over lifting its arms embargo on China, and the strong voices of opposition that were raised to such a course of action among European legislators and in the European media, exposed the limitations of the rhetoric of EU-Chinese rapprochement.

Second, from a semantic perspective, much, if not all, European talk of a new multi-polar world is descriptive rather than prescriptive. Rather than advocating multi-polarity, many Europeans see the emergence of multi-polarity as an inevitable consequence of the end of the Cold War and the rise of new powers, especially China.

Third, although Europeans might talk of the emergence of a multi-polar world, their preferred vision is of a multilateral, rather than multi-polar world order. European nations, more than others, have experienced first hand the dreadful consequences of trying to sustain multi-polar balances at a regional level. Following the Second World War, European leaders decided to eschew this failed strategy and develop a new European order based on a program of economic and political integration which has at its core, a dilution or “pooling” of national sovereignty within the structures of the EU. European leaders would undoubtedly like to export their model of governance internationally. Chinese leaders, however, with their obsession over preserving sovereign prerogatives and sovereign freedom of action are far from sharing this EU vision.

III. Implications for the Transatlantic Alliance of China’s “Strategic Relationship” with the EU

Chinese ambivalence about multilateralism and EU ambivalence about being drawn into a multi-polar world order with China do not lessen either side’s desire to develop a broad “strategic partnership.” The reasons are relatively straightforward. On the one hand, there is the economic driver. The volume of EU-China bilateral trade has grown exponentially in recent years, and China is now the EU’s second largest external trading partner behind the United States. European companies have also taken advantage of the Euro’s recent strength in recent years to finance growing levels of direct investment in China, especially since China’s hunger for infrastructure investment plays to the strengths of European companies. For their part, Chinese companies are now starting to invest in middle-sized companies in Europe, at this stage primarily to gain technical know-how and expertise, but, ultimately to access the EU market more directly.

The expectation is that this bilateral economic relationship could overtake the transatlantic economic relationship in trading terms in the coming years, even if the “deep integration” caused by levels of transatlantic foreign direct investment would take decades to replicate. Efforts to capture this “new economic space” have already and will continue to create a potentially divisive competitive dynamic into the transatlantic relationship.

A second impetus behind the talk of a “strategic relationship” is described by the European Commission’s September 2003 report on EU-China relations. The report concludes that China’s actions will have a direct effect on each of the key challenges facing the EU and the world in the coming decades, whether this involves stemming the proliferation of WMD or the spread of global health epidemics, managing world

energy supplies, controlling environmental degradation, embedding respect for intellectual property, or driving global economic growth. The report concluded, therefore, that “it is in the clear interest of the EU and China to work as strategic partners on the international scene.”

These two drivers—the bilateral economic agenda and the sense of China’s growing impact on questions of global governance—have given rise to a plethora of regular EU-China ministerial meetings, working groups, official visits, and educational and scientific exchanges, all overseen by annual EU-China summits, that together are giving some shape to the label “strategic” in the EU-China relationship. A third factor in the emergence of this “strategic partnership,” therefore, is the level of comfort that negotiators in China and the EU appear to have in developing such a multi-layered agenda. China’s decentralized and incrementalist system of governance appears to mesh well with the EU’s own decentralized and consensual forms of internal coordination.

Clearly, EU leaders hope that engaging their Chinese counterparts in this web of consultations will help “socialize” China both to undertake gradual domestic economic and political reforms and, ultimately, to become a more constructive player in international fora such as the UN.

This strategic vision of the EU in how to develop its relations with China poses a near-term challenge to the United States and to the transatlantic alliance. On the one hand, the United States had grown accustomed from the 1970s through the mid-1990s to being the dominant interlocutor with China at a strategic level. U.S. commitments to security in East Asia, its alliances with South Korea, Japan, and Taiwan, and its deployed military forces inevitably gave it a pre-eminent diplomatic position. The United States has not been accustomed to having to consult with European leaders on its China policy.

Today, U.S. policymakers must take into account a more triangular relationship with China within which the EU is an increasingly important player at the political and economic levels, but without possessing the encumbrances of America’s security commitments. The intense transatlantic dispute over plans to lift the EU arms embargo on China in 2004 and early 2005 exposed the differences in approach that each side can bring to its relationship with China.

The need for transatlantic coordination on China is imperative. European and U.S. leaders share the same basic strategic objectives toward China, whether promoting China’s domestic political reforms and the further opening of its economy, limiting its role as a weapons proliferator, or encouraging China to play a constructive role in regional Asian security. However, China presents the United States and its European allies with the difficult challenge of needing to coordinate closely their diplomatic approaches even while sustaining their distinct bilateral lines of communication and influence. This means that the United States must be open to dialogue with its EU counterparts on an effective strategy of incentives and disincentives to China that will support its integration into global institutions. For their part, European leaders can no longer keep difficult questions of Asian regional security separate from their burgeoning economic and diplomatic relationship with China.

Cochair TEUFEL DREYER. Thank you very much, Dr. Niblett, for your attention to time. The first question goes to Commission Chair D’Amato.

Panel VI: Discussion, Questions and Answers

Chairman D’AMATO. Thank you, Madam Chairman. I have a question dealing with the EU arms embargo. I think I heard you say, Mr. Dent, that the relationship between Europe and China was unencumbered by national security. Is that accurate?

Dr. DENT. Largely unencumbered I would say.

Chairman D’AMATO. Largely unencumbered. I would say that we feel that Europe bears a certain responsibility to the security situation in Asia, particularly the Taiwan Strait. I think that was the issue with the EU arms embargo, and it was a close call. The Chinese helped us out by passing some very hostile legislation dealing with Taiwan. I think that threw the balance over.

How long is the EU embargo going to stick? Because our feeling is that we’ve just had a report from the Pentagon on Chinese mili-

tary power indicating a very robust, aggressive growth of Chinese military capabilities, particularly in the Taiwan Strait. That's the key problem as we see it.

So anything that adds fuel to the fire there is a national security concern for the United States since we have a commitment to defend Taiwan in case there is an aggressive move by the Chinese. What do you think in your conversations on the continent about the long-standing nature of the embargo? Is it going to stick or are we going to see it dissipate?

Dr. DENT. I believe you're going to see it stick for forthcoming years. I notice like many issues of EU policy, it's a matter of bargaining and resolving conflicts of interest between different EU member states and countries like France, Germany have been pushing for the embargo to be dropped. Other countries like the Nordic countries have been wanting the embargo to be maintained, and countries like Britain and Spain have been somewhat ambiguous so far. That's my understanding.

But my feeling is that the EU will stick with the U.S. policy on this.

Chairman D'AMATO. Yes, thank you. Isn't it the case that in Europe there is sharp divergence in views as between European legislatures and executives as to this which leads me to believe that the multinationals are pressuring the executives, but you've got the Dutch parliament, the German parliament, the European Parliament itself who have voted overwhelmingly I think to keep the embargo on. So there is this division of view; is that right?

Dr. DENT. Yes. My understanding is that the European Parliament has been a staunch defender of Taiwanese interests for a long time. It goes back to the 1980s. The extent to which the European Parliament can be an influential stakeholder or center of interest in this I don't know.

The European Parliament has had its powers and influence strengthened in recent years, but my gut feeling is that the embargo will be maintained and will be in place for sometime.

Chairman D'AMATO. Thank you.

Cochair TEUFEL DREYER. Vice Chairman Robinson, please.

Vice Chairman ROBINSON. Thank you, Madam Chairwoman. I must say, Dr. Dent, I was impressed with the notion that we're all in this together in trying to bring about a more democratic pluralistic system in China, more balanced market oriented growth, those types of goals. And yet you couldn't miss the feeling that there is a division of labor implicit in your remarks between the United States and Europe, notably we take care of security concerns and trying to advance democratic pluralism and the cause of freedom, and Europe will take care of unfettered trade and the more encouraging dimensions of engagement with China.

I think the Chairman was making the point that that's not on in the sense that that's not a sustainable transatlantic policy. That's why we had this non-trivial row over the EU arms embargo that I happen to believe is going to be lifted as soon as the British presidency of the EU concludes probably in the first quarter of next year, but that's my own view.

It just seems to me that the Congress in particular—which we try to obviously stay in close coordination—is increasingly troubled

by, at least, this perception that we'll hold your coat, but you know you're going to be in the blood and treasure side of this equation. That is we, the United States.

So I think that there has certainly been more dialogue stimulated since this debate and that's a good thing. We were in Europe and, in fact, warned of this kind of disconnect back last December and I think we were one of the first congressional groups to go to the EU and, in effect, sound the early warning alarm, and indeed that fire took place.

So I'm curious as to whether we're going to be able to harmonize our policies, not believe that there is a real division of labor here, and what the prospects are of coming together on this to a greater extent because I think right now it's still a perilous disconnect.

Dr. DENT. Yes, I agree. It is a matter for concern. I guess all I'm doing is just reporting on the reality of the situation. I agree there is an unsatisfactory division of labor with regards especially to security responsibilities in East Asia, and what you just mentioned about one outcome of these discussions is that there is a much stronger understanding about any imbalances in the relationship, and that is a basis to move forward on these kind of issues of re-addressing this imbalanced division of labor.

I don't think there is anything more I'd like to add to that apart from what else can we do? What do you believe we can do to help readdress this? How can Europe take greater security responsibilities in East Asia and the Asia Pacific?

Vice Chairman ROBINSON. Well is that not fueling a robust offensive military buildup would be a nice start. And the lifting of the EU arms embargo would be a rather calloused, insensitive and unwise policy at this time.

Even if it's in the first quarter of the first half of next year. That's going to be well too soon and the Congress is laying in wait and there will be a response and it won't be pretty. It will be in my mind, at least, well deserved. So I think that we might start there.

Dr. DENT. Thank you.

Cochair TEUFEL DREYER. Dr. Niblett has a comment to make.

Dr. NIBLETT. If that's all right, just very quickly on the arms embargo issue. If we end up, we the United States and the EU, end up gauging Europe's commitment to Asia's security and the security of the U.S. allies purely by whether it sustains the arms embargo or not, then I think we'll be doing an injustice to the reality of the situation in East Asia right now.

As we all know, European companies primarily, some U.S. companies potentially, but European companies primarily have continued while that arms embargo has been in place to export significant amounts of dual-use equipment to China, some of which have found their way over into, quote-unquote, "defensive military systems," and which are providing China with potentially and precisely the types of equipment that are of concern to the United States—radar, some satellite technology, et cetera. I think this Commission has already heard the types of items that are already being exported today while this arms embargo is in place.

My personal view would be that the status quo is not good enough and to simply ask for Europe to sustain the arms embargo

and try to hold the situation as it is is not the, is not the solution. While we have this gap—and I happen to believe also I think over time, and time might be the latter half of next year, that the embargo may still be lifted, I think the political decision has been taken. It's the timing that is now the question—that we are in a race to try to really achieve at least three things.

Number one, come to some understanding agreement of what these technologies and items are that the United States and the EU do not want China to get hold of in the next three to four years, and that list will have to be updated every six months or every year, given the pace that technology has been developed at, and this is not covered by the arms embargo. This is technically covered by the EU dual-use agreement, which, by the way, is legally binding, and yet it still allows many of these items to go through.

So for the U.S. to get a much better understanding of (a) national arms export control policies throughout the EU, because there is where the real rubber meets the road; and secondly, why is it that if the EU has a dual use export control agreement, why is that dual use export control agreement not controlling precisely these systems that we should all be so worried about?

Secondly, very importantly, the human rights question. The EU has always put the human rights element in there as supposedly one of the provisos for why and when it would lift that embargo. Clearly, the anti-secession law was one of the excuses that let the Europeans stiffen the backbone and say, okay, we won't lift the embargo, but it was also the fact that the People's National Congress did not lift the U.N. International Convention on Civil and Political Rights. What are the three or four benchmark steps that the U.S. and the EU ideally together would want to set that would constitute positive progress in terms of human rights? Because otherwise what will happen is the Chinese government will be able to, in essence, game the difference between the U.S. and the EU approaches on human rights and potentially again will have the kind of conflict that Mr. Robinson mentioned.

Thirdly, what is the view on Taiwan? The EU has yet to develop a view on Taiwanese security. That's ultimately what we're talking about when we talk about security in the region. Primarily it is Taiwan, and this is something again the U.S. can work very strongly with the EU on what type of political signal does the EU send to China if it lifts the arms embargo without having a more robust view on Taiwanese security over time, which as Chris Dent mentioned, is something that not just the European Parliament, but the British House of Lords, the German parliament, a lot of the national legislators are also very concerned about.

So I would just put those three items out as requiring urgent attention over the next six months to one year.

Cochair TEUFEL DREYER. Thank you, Dr. Niblett. Next question to Commissioner Wessel.

Cochair WESSEL. Thank you both for being here. It's provocative testimony that really challenges us and the overall relationship as to where we go in the future. China is a hinge point in terms of where we move on economics, on security and other issues in the future.

I'd like to pick up on the comments about multilateralism versus unilateralism. It often appears that the Europeans profit from multilateralism in the economic sphere and that we bear the costs of unilateralism, and as Vice Chairman Robinson indicated, that the Europeans often appear to be willing to "hold our coats" while our noses get bloodied in the economic fights. I'm reminded of what happened in the 1980s with Japan where the Europeans were rather aggressive with Japan in terms of limiting access, for example, on autos. There were performance requirements that required 80 percent of the parts to be sourced out of Europe.

They were definitive about what their national needs and desires were, but when the U.S. sought either through voluntary restraints or other approaches, we were labeled to be protectionists. How can the U.S. and the European Union work better together on economics to ensure that China's multilateral commitments, for example, in the WTO to respect IPR, to impose rule of law, to go broadly on a number of other issues that there has been fairly broad retrenching on the commitments that they've made that are economically important? How do we work together? How do we bridge that gap and not get into the situation—I think Dr. Niblett just said—of allowing China to ply us versus the EU and the relationship against one another?

Dr. DENT. I believe the U.S. and the EU are already working on these issues with regards to China. If you look at the process by which China acceded to the WTO, whilst there were separate bilateral negotiations China had with the U.S. and with the EU, the agenda that they had was broadly similar. No doubt that the USTR and the European Trade Commission do dialogue on issues within multilateral fora such as the WTO. Regarding the IMF, not so because the EU does not act as a single interlocutor on international financial issues.

But there is the G8, of course, where the major EU powers—Italy, France, Britain, and Germany—come together with the United States and also with, of course, China, which is likely to become a G8 member in the next few years. These frameworks still exist for dialogue. All I'm promoting here is that these frameworks be used more effectively.

Cochair WESSEL. Well, let's take two recent issues. For example textiles, where the Europeans reached a managed agreement with the Chinese recently, as well as coking coal, for example. Export of resources, as you know, cannot be prohibited under WTO rules. China prohibits the export of that one resource. The Europeans complained and then worked out a managed deal to accept a certain percentage while the U.S. continues to seek broad rights and does not negotiate separate deals to the exclusion of others. Should we be just negotiating for our market and leaving the Europeans on the hinge as the Europeans appear to be doing in certain instances? We appear to be going only for our own interests rather than as was argued a multilateral interest.

Again, going back to Japan, the Europeans seek to protect their own market and then accuse the U.S. of being protectionist when they ask for broad access to the Japanese market and don't get it.

Dr. DENT. Regarding Japan relations, the U.S. initiated the Structural Impediments Initiative back in the 1980s, which sought

to broaden market access for EU, for U.S. products. So that would seem to be something similar to what the EU was doing in the Japanese market.

I don't know. I'm not too sure the EU—about your take on them labeling the U.S. as protectionist with regards to these matters. That may be the case in certain quarters, but what I'm trying to do ultimately here is trying to develop a kind of approach or mindset towards trying to work out these common global economic problems in a more cooperative and constructive manner and understanding that the nature of globalization which is not just disconnecting different material parts of the world economy more together, but also issue linkage, trade and environment, for example.

These are common problems that face us all as an international society. And what I'm trying to do here is just emphasize the importance of approaching these issues, addressing them effectively from a multilateral manner.

Cochair WESSEL. I clearly agree, and as has been raised, the EU arms embargo, we're arguing for a common multilateral approach, economics, arms, national security interests. It often appears that the Europeans are willing to negotiate for themselves under the cover of that multilateral umbrella and then labeling us protectionists or labeling us as unilateralists while basically swinging in under the cover of our actions.

Dr. DENT. If that interpretation is correct, then I concur with your view. That should not be really permitted to continue. The Europeans have as much responsibility and duty to commit to developing systems of multilateral systems of global governance and seeking not just their own national or regional interests but to see the interests of international society. That's what I believe.

Cochair WESSEL. Thank you.

Cochair TEUFEL DREYER. Thank you. Commissioner Mulloy. By the way, we are running short on time, so if everyone is going to have a chance to ask a question, we need to keep our questions and answers brief.

Thank you.

Commissioner MULLOY. Thank you. Thank you both for being here. Dr. Dent, in the final page of your testimony, you say that it is imperative China, Europe and the U.S. to work on oil dependency. We strongly recommended in our last report that we find some way of bringing China in association with the International Energy Agency.

We know they can't come into the OECD because they're not a democracy, but we thought some associative relationship ought to go into place there. So we agree with you on that.

You used trade figures on page four of your testimony that we have an \$80 billion, and our figures suggest we have more, \$165, \$170 approaching \$200 billion, and that Europe's is twice as much as the figures you used. Where did you get those figures?

Dr. DENT. Well, there are lies, damn lies, statistics and then statistics about economics.

Commissioner MULLOY. Yes.

Dr. DENT. And it's a contested issue, statistics. Obviously the Chinese are using these kind of figures to suggest the trade deficit problem is not a problem,

Commissioner MULLOY. Are these the Chinese figures?

Dr. DENT. As I said, yes, in the paper they're from their Ministry of Commerce.

Commissioner MULLOY. From the Chinese Ministry of Commerce.

Dr. DENT. Yes, Chinese Ministry of Commerce.

Commissioner MULLOY. Okay. That helps explain that.

Dr. DENT. Yes.

Commissioner MULLOY. As you know, some people say there's a "democracy deficit" in the EU. Our Congressmen in the House get elected every two years, the Senators every six years. They're pretty closely attuned to what's going on among the people.

I watched the elections in the EU and the rejection of the new constitution in France and the Netherlands, and then I looked at the breakdown on where that vote came from. Among the working people there's a lot of rejection of the current model of globalization and a rethinking of where that is going.

I don't think that's reflected in the elites in Europe who are tied much more closely to the view of the world propagated by the multinational corporations. Do you agree that there is a disconnect somewhere and that we ought to be working more closely on how we deal with this global economy? Because I think the people think that it isn't working to their benefit.

I'd like to hear from both of you on that.

Dr. DENT. I think that's in Robin's expertise.

Dr. NIBLETT. There are many reasons why the constitutional treaty was rejected in those two countries. Undoubtedly, one part of it was a fear of how globalization is affecting people's economic security and the security of their welfare. However, my interpretation, if you want to start to pick a majority feeling, is that European leaders and politicians have not come up with the right answer to globalization.

It's not just globalization per se that the people are rejecting. They're rejecting the fact that they've been living with ten percent plus unemployment for the last five or six years while everyone said the EU was going to be the answer to protect the European countries from the forces of globalization.

It's the fact that they've been living with 0.3 to one percent economic growth. The fact that they're seeing, they know the pension system may not be around, you know, in seven, ten, 15 years depending which country you're in.

My sense is there is much more fear and insecurity about globalization than opposition to globalization itself. I think that's a very important component because when you start to talk about what is the majoritarian view, what's going to be able to impose change or not, you start to see change happen. Change has started to happen in Germany. Change has started to happen in France.

Collective bargaining deals are starting to go by the way. Flexible working is starting to come in. There's opposition to it which is the reason we have an election coming up in Germany because ultimately the socialist chancellor could not push it through his own party, but if Angela Merkel wins there, you will see a different type of policy go forward.

It won't be a Thatcherite or Reaganesque type of Anglo-Saxon liberalism, but it will be a shift. In my mind, there is no doubt that

European publics are looking for a way to live with globalization. Let me say this also because this is not a China issue.

Commissioner MULLOY. No.

Dr. NIBLETT. The Europeans are already living with it because when they enlarged to 25 countries, they brought globalization inside the EU.

Commissioner MULLOY. But China is a big part of the globalization issue.

Dr. NIBLETT. Absolutely, and I think China could be the next, is the next problem in essence of it.

Commissioner MULLOY. Dr. Dent, do you have any views on this to offer? Do you think that there is some kind of rejection or of the current model of globalization reflected in these votes in the EU?

Dr. DENT. Well, globalization is even more contested than trade statistics, and different interpretations on it. I won't go into a debate about globalization per se, but, yes, a belief, you're more or less right. I would concur with everything that you've said. When you talk about a democracy deficit, that to me connects more with how the EU manages itself as a complex multilateral, multi-level system of governance with different supranational organizations, intergovernmentalism.

But the point that you made about the disconnect between the elite and the people, I believe does strike a chord and it's something which we are examining very closely now in Europe. But we have been doing that for a while, but post these constitutional rejections, we're going to be doing it in a more intensified manner.

Commissioner MULLOY. I think that's an area that we can profitably work together on, the United States and the EU, thinking about how we're managing this globalization problem.

Dr. DENT. Certainly.

Cochair TEUFEL DREYER. Commissioner Donnelly.

Commissioner DONNELLY. Thank you. I'll try to be on time and under budget. But I did want to draw out both panelists on their view of the real strategic role of Europe. I was struck by Dr. Niblett's distinction between multilateral and multi-polar orders. I'm not sure that I understand the distinction. There are either multiple actors in international politics and whether they're poles or sides or whatever they are, it seems to me to be functionally the same thing.

I was also struck as a second point about what Dr. Niblett saw as the basis for a strategic partnership between the EU and China, things like the environmental degradation, AIDS and other health issues, and nonproliferation. That seems to be pretty thin gruel at least by traditional historical standards for a genuine strategic partnership like they agree over, maps and armies and things like that.

Finally, there has been discussion about European values particularly in regard to the use of force. I would say both China and the United States still regard force as a legitimate tool of statecraft and policy. But if Europe continues to absent itself or abstain one way or the other, (a) it has a deleterious practical effect on the United States and (b) that's not a set of rules that China plays by.

So if somebody or both of you could take on those three issues, I'd appreciate it.

Dr. NIBLETT. I'll jump in. To me, multi-polar/multilateral are fundamentally different concepts, I mean completely. I'll try to be brief in my understanding of how different they are.

Certainly from the EU perspective, when you think about how the EU talks about multi-polarity, the U.S., the EU, China, India, Russia, almost five blocs in essence which should be operating against each other or balancing off against each other. That is a realist view of international relations theory that that is perhaps a solution.

For most European experience, to try to achieve stability through the interaction of disparate power centers has led to conflict and death and destruction which is why at the end of the Second World War, the European countries went for an alternative solution that actually led to a dilution and a pooling of sovereign power in a multilateral system that is far less cognizant of and accepting of sovereign rights.

I think that the distinction therefore for me, at least the difference, is that the EU would like to draw China into a less sovereign approach over time, 30 years, 50 years, they'll take the long view. They would like to draw China into a more active involvement in the kind of international norms and international legal systems that the EU itself is trying to promote for world order.

Whether you agree it's the right solution or not, that is what they're trying to do, and you can see this within the U.N. This has been a European view from the Kyoto Protocol to the International Criminal Court. It's a view of trying to spread a different system of governance and that multilateral approach is very different from the multi-polar approach.

Secondly, I think that if the EU does not reference armies and maps when it talks about strategic, that is the way the EU thinks of strategic, it doesn't think of strategic as involving maps and armies. The EU thinks of strategic again as an extension of its own experience, which is that the strategic unification of Europe was achieved initially by a coal and steel agreement, this was a very gradual approach where the integration of particular economic relationships, infrastructural relationships, hence the environment, coordination of health officials, gradually lead to a change in the behavior of a country such as China, where it will start to act more like the United States and the EU and less like it is today which is obviously still somewhat of a cutoff and definitely an authoritarian and one-party state.

So that is a strategic objective for the EU which it believes cannot be achieved through the application of military force and ultimately the application of military force or the threat of it will be counterproductive.

In that sense, when the EU talks about a strategic partnership, it is the whole of those 20 working group areas that they're working on right now which go from human rights to rural development to environment to peacekeeping, training. They're covering the whole gamut, and strategic means comprehensive for many Europeans, not strategic in the sense that I think you referenced it.

Maybe I should set aside in the interest of time the views of force unless you want me to take that on as well, but—

Cochair TEUFEL DREYER. Commissioner Bartholomew.

Cochair BARTHOLOMEW. Thank you, Madam Chairwoman, and thank you to our witnesses. I want to start with a personal remark which is acknowledging condolences on the recent terrorist attacks in the UK and to note that we stand in solidarity with the people of Europe in this fight against terrorism.

This is not so much a question as an observation. In a lot of ways, the divide between the panelists and the Commissioners in this discussion—it's not as though I've felt like we've had a divide between our other panelists in terms of viewpoints.

To me that represents a troubling aspect of what is happening in the transatlantic relationship and the need for dialogue. It is hard—you probably can see this—for us to come to any conclusion other than the fact that what's driving the EU's strategy or objectives in the relationship with China is anything really other than money, and that the rest of it is a nice framework to point to.

But it seems that the decisions are economic ones and how we deal with all of the rest of these things are the icing on the cake. Dr. Niblett, in particular, I would point out that economic reform can political reform, but it doesn't necessarily do so, and Singapore, of course, is a perfect example of that, and it's not fair that I keep putting these issues out there, so if you have comments, I'd appreciate them. One final observation is that I'll disagree with Commissioner Donnelly on the relative significance of insignificance of some of these other issues, including health issues.

Of course, we face in this world the possibility of a global pandemic starting with bird flu and I'm sure some of you have followed that at least three people now in Indonesia have died of the bird flu, and I think that there are some pretty serious questions about the Chinese government's lack of being forthcoming about what's happening with avian flu in some regions in China.

So the consequences of not having an open government over a short period of time could be quite significant for the world. I don't mean to be alarmist; I'm not saying it's necessarily going to happen. But it's a very real threat that we have to face and that we have to confront. So sometimes on some issues we don't have the luxury of 40, 50, 60 years before reforms happen. Those are just observations. Thank you.

Dr. NIBLETT. Can I just make one comment? Clearly, the EU, as I'm sure are a lot of U.S. companies and others, is driven by commercial interests. The interest in accessing the Chinese market is overwhelming.

Let me say also that there is somewhat of a difference. The EU companies are specifically designed in much of their comparative advantage to be able to take advantage of what China is doing right now: the infrastructure, the nuclear power plants, the telecommunications networks, the rail networks, et cetera, they play to an EU strength, and much of the competition is between EU and Japan and not even the EU and the U.S., setting aside obviously aircraft.

Plus the EU depends hugely on exports right now for jobs at a time when you've got ten percent unemployment in Germany. Germany nonetheless has become, as you know, the world's larger exporter and a lot of that exporting is going on to China, so the idea

of putting that at risk clearly gives politicians, and you said that you're close to the people, it gives them pause for thought.

Sorry, you didn't, but the point was made that you're close to political thought and the political thought is jobs and jobs obviously will drive political decisions. I think there is—and you said it—there's a divide. The divide comes because my sense is that you are laying out a straw man of the European view in the bulk of the questions that I heard placed here today.

And then inevitably the response you'll get, at least from me, and I think from Chris Dent as well, is to play against the straw man rather than talk about the actual, talk about the issues, and I think that ultimately there is a genuine, genuine, interest in Europe to view long-term engagement with China on issues like the environment, energy, migration, proliferation, as genuine strategic questions; that simply treating China on a more conflictual approach that at least I hear through some of the questioning would be counterproductive.

And almost that the U.S. policy leads to self-fulfilling prophecies and that the European approach may lead to change. Now, let me come to your final point. I happen to agree with you that a one-sided EU approach that focuses simply on incentives and not on sticks is going to fail because if there is anything that's been proven over the last few years, it's that China is going to do what China wants to do.

Wishful thinking is not going to achieve change in China. I think the most interesting area on that was the arms embargo. If China had not passed the anti-secession law and had ratified the U.N. Convention on Civil and Political Rights, as it was expected to do in March, the arms embargo would be lifted. So ultimately China does what China wants to do, and I think the EU needs to understand that better than it does right now, and I completely take your point. Just as detente didn't lead to the collapse of the Soviet Union, economic reform and economic integration need not lead to the end of Communism in China.

But to say that all of the European approach is simply driven by commercial greed or need and that the U.S. approach is simply the principled approach, that's the divide is how it sounds from this side of the panel is going to lead to the kind of comments we're making back again.

Thank you.

Cochair BARTHOLOMEW. Just one response quickly and then Dr. Dent. And Dr. Niblett, you're absolutely right. The U.S. policy concerns that many of us have about the U.S. policy is that it also has been driven by commercial interests rather than some of these other things. So I'll acknowledge that point.

Dr. Dent.

Dr. DENT. Yes. I just wanted to say that I think the reason why there is so much contention and division is because there is so much substance to the EU-China-U.S. triangular relationship and so much at stake, and this is what happens. When you do engage in another partner, whether it's commercially or in any other kind of way of building alliances, and there's a lot of a substance to that relationship, it's inevitable that contentious issues arise. The U.S.-

Japan and the EU-Japan relationships that emerged in the 1980s and 1990s clearly revealed that too.

On the issue of health, you've identified there a typical trans-border issue which needs to be addressed on a multilateral way because things like avian flu, pollution, they don't actually respect national borders; hence, that requires a multilateral or at least an international cooperative approach to address these issues.

Going back to Mr. Donnelly's comment about multi-polar/multilateral, just briefly, to me the essential difference is that multi-polarity is more to do with structure and multilateralism is more to do with process. Multi-polar in terms of the distribution of power in the international system, which may or may not then precipitate the needs for a multilateral process of cooperation, dialogue and so on to address problems that arise because of interconnections between those multi-polar powers.

Thank you.

Cochair TEUFEL DREYER. A very brief final question for Chairman D'Amato.

Chairman D'AMATO. Thank you very much, Madam Chairman. You know while we've talked here a lot about integration into international structures, international citizenship, the United States and the Europeans went to great lengths to get China into the WTO and that's wonderful.

The problem is that neither of us have worked to bring the Chinese into the WTO by bringing any cases. The Europeans have brought no cases. The United States has brought one case. We go and visit the European Community and we visit the WTO in Geneva and we find out, we ask why, why didn't we bring any cases? IPR, piracy are rampant. How are you going to solve it if you don't bring any cases? And the answer we get unfortunately is we don't want to bring cases because the Chinese are going to retaliate against our companies.

Now, we're going to have either a rules-based international order or a fear-based international order. It seems to me that using the WTO would be a litmus test of whether we're going to a rules-based order.

Do you have any response to that?

Dr. DENT. Yes. Very simply, the WTO needs to be improved in a various number of areas. You've identified one of them.

Commissioner MULLOY. Do you have other improvements in the WTO that you want to tell us?

Dr. DENT. Oh, well, how long have we got.

Cochair TEUFEL DREYER. 30 seconds.

Dr. DENT. Okay. The way by which the agenda is set, the reconciling interests between developing and developed countries, rules on regional trade agreements, rules on anti-dumping. The whole agenda really requires serious—

Chairman D'AMATO. But if you don't bring cases to implement the agenda, the organization isn't working. That's the problem we see.

Dr. DENT. Yes, I guess things try to resolve at the bilateral level first before they're taken out. Yes.

Chairman D'AMATO. Well, there are plenty of examples of not solving anything at the bilateral level at this point with China.

Dr. DENT. It's a slow-making process.

Chairman D'AMATO. Yes, very slow. Yes.

Dr. NIBLETT. Can I say one thing on that? The U.S.-EU Summit that took place here on Washington on June 20 did put third country application of IPR as a topic for joint action—there was a whole separate statement on this, and the Commerce Department and others, I know, are trying to work on that issue right now. I perfectly understand the EU has been somewhat resistant, more so on this side, than the U.S.

But it is an area that's been focused on. The TransAtlantic Business Dialogue and other business groups are coming forward and saying we need to work together on this. U.S. and European businesses are saying we want you, the U.S. and EU governments, to tackle this together because otherwise we are going to be gamed.

Chairman D'AMATO. Yes, and there is a parade of U.S. officials that goes to China and talks about IPR. We've got excellent jawboning. No progress. Seems to me we're not going to have any progress in some of these areas until we bring cases in. Then the Chinese know we're serious. Thank you very much, Mr. Chairman.

Cochair TEUFEL DREYER. Thank you. I declare this panel at an end. Thank you both gentlemen for your very important testimony and just a two-minute break while the second panel takes its place.

[Recess.]

PANEL VII: CHINA'S APPROACH TO NORTHEAST AND SOUTHEAST ASIA

Cochair TEUFEL DREYER. Let's resume. Unfortunately we are very limited on time today. Going, as we do, traditionally from left to right, there is no ideological—

Commissioner DONNELLY. From there it's right to left.

Cochair TEUFEL DREYER. Yes. Whichever way, but in this case it's my left. Dan Blumenthal, who is a Resident Fellow at the American Enterprise Institute, previously served as Senior Director for China, Taiwan and Mongolia in the Office of the Secretary of Defense for International Security Affairs.

Prior to that, he practiced law in New York and has authored numerous articles on China's role in East Asia and elsewhere. Mr. Blumenthal, the floor is yours.

STATEMENT OF DANIEL BLUMENTHAL RESIDENT FELLOW, THE AMERICAN ENTERPRISE INSTITUTE

Mr. BLUMENTHAL. Well, thank you very much. And thank you very much to the Commissioners for calling me to testify on this very important topic: the impact of Chinese economic and political and military growth on North and Southeast Asia. I think the questions that are posed go to the heart really of China's grand strategy in Asia and its national aspirations in Asia and I think those aspirations are to emerge over time as the dominant, the pre-eminent power in Asia.

It's going about this, I think, in ways one would expect from an emerging power, but a power that has learned the lessons of the past. I would say that probably just to simplify, there are probably three elements of Chinese strategy that one can discern. The first is what it calls building up its comprehensive national power. The

second is to reassure the region that it, in fact, doesn't have revisionist, non-status quo or aggressive tendencies, and the third by necessity over time is to displace the United States as the pre-eminent power, in their minds, hopefully peacefully.

So let me begin with comprehensive national power. And here what the Chinese mean is to build up all elements of power in unison. Economic growth is critical, of course, but so is military power and building political leverage that comes with economic exchange and growth.

For Chinese strategists, a critical piece of comprehensive national power is what they call the "peaceful reunification of the motherland," which really is holding together the multi-ethnic empire they now have and also bringing other, quote-unquote, "Chinese territories back into the fold after the century of humiliation," that in their terms they've experienced. And this is where Taiwan becomes such a high priority for China because the breakup of the Chinese Empire in their terms has weakened it and to gain it back its great power status, it needs to reverse that and require or acquire Taiwan.

So, much of China's military strategy, at least in the short term, is meant to intimidate, coerce or force to compel Taiwan to come back into the fold.

But on the other hand, China is quite deliberately creating an economic interdependency with Taiwan in order to convince Taiwan's public to join the "motherland." So economic growth is, of course, a very big part of comprehensive national power and so is keeping relations with the United States and other export markets stable, at least for now.

And of course, the need for growth explains this tremendous amount of economic engagement that China has now with the region and the institutions through which that engagement occurs. Just to name a few, the Association for Southeast Asian Nations, Foreign Trade Agreement with China, the bilateral foreign trade agreements. The statistics are all over the map, but clearly there has been a tremendous rise in trade with Asian nations.

On balance, I think Asian nations have benefited economically from trade with China, although of course certain sectors have been harmed and there have been some diversionary effects on foreign direct investment and so forth.

But there's also no doubt that China uses economic relationships in Asia and sees them in strategic terms as well, meaning wanting to influence governments politically.

Taiwan is just the most glaring example of this and Taiwan of course is now a major investor in China and its exports are now 24.5 percent of Taiwanese exports now go to China. Hundreds of thousands of Taiwanese businessmen are doing business in China. And China, just as an example of using political leverage, has encouraged these businessmen, for example, to go to vote for the more pro-China Pan Blue ticket in the 2004 presidential election.

But other countries besides Taiwan feel this pressure as well, and I think just another example is Australia. Australia and Chinese trade have almost quadrupled in the past decade and not coincidentally China has attempted to apply political pressure to change Canberra's attitude towards the alliance with the United

States, particularly as it pertains to Taiwan. The key word here is has attempted to. It hasn't been successful.

China clearly targets other countries for economic and military aid in exchange, countries that it sees as strategically important for reasons of energy security, and here Burma, Cambodia and Thailand come to mind.

Of course, Beijing doesn't trust the United States Navy to ensure safe passage of its increasing amount of oil imports from the Persian Gulf, so it's trying to mitigate those vulnerabilities and Burma provides a possibility for an overland alternative through the chokepoints of the Malacca Straits.

And Burma has been the recipient of billions of dollars of military assistance from China and hundreds of millions of dollars of economic assistance in recent years.

Let me go to the second goal which is reassuring the region, and David Shambaugh of the George Washington University, has written eloquently about Chinese newfound fondness for multilateralism in Asia. China, for example, is increasingly involved in regional organizations and dialogues, particularly the ASEAN Plus One and Plus Three, the ASEAN Regional Forum, the Shanghai Cooperation Forum. The list goes on and on. The particular fondness for fora that excludes the United States. And more on that later.

So while China on the one hand is building up its military quite ambitiously, and the latest Pentagon reporting has a defense budget of some \$90 billion, making it the third-largest spender in the world, it's at the same time working to reassure the region that this is all about, quote, "preventing Taiwan independence." Taiwan is the problem. Once we take care of that, don't worry. I guess we'll build down and draw down and get rid of our weapons.

The region is not buying that, I don't think. In my view, China has not all of a sudden adopted a European allergy to use of hard power and the use of force. It's a means to reassure the region until such time as it has the hard power to be able to use it.

The last and I think I most controversial goal is gradually displacing the United States, and here a complex strategy and a long-term strategy is in effect. Simply put, as China grows strong enough and successfully reassures the region, thus preventing balancing coalitions from forming, it may not have to directly confront the United States with force.

China must also break and fray Washington's alliances, so here we must pay special attention to actually the nature of China's military buildup, not just the numbers. As the DoD report pointed out, the focal point of China's military buildup are ballistic and cruise missiles, destroyers and submarines, and they're all mobile and deployable in areas besides the Taiwan Strait.

The introduction by China of ballistic missiles and submarines and fourth generation aircraft, what is called in military jargon anti-access or sea-denial capabilities is meant to call into question over the long-term the credibility of U.S. commitments to the region, to its allies and friends. This is compounded by a growing and more credible intercontinental ballistic missile force, more credible nuclear threat.

And the idea here is put doubts in the minds of allies and friends that the U.S. has the will and ability over time to continue to be the regional provider of security.

In China's view, a level of military capability which it's not that far from attaining combined with successful leadership and regional for a that exclude the United States will persuade nations to accommodate themselves to Chinese predominance and force them to think the partnerships and alliances with the United States.

Cochair TEUFEL DREYER. Mr. Blumenthal, could you sum up please.

Mr. BLUMENTHAL. I think, in sum, the strategy is not fully working, particularly when it comes to Taiwan. How can you, on the one hand, claim peaceful intentions and on the other hand be very threatening in terms of Taiwan? I think you see a number of Asian militaries actually doing quite a bit of balancing and even joining in containment, although nobody would actually call it that. You see force modernization in Japan, Australia, India, for example, that have—in Australia that has interoperability with the United States foremost on its mind and also, of course, you see upgrading our alliances and partnerships with Japan, Australia, India, Vietnam, and Singapore.

So there's actually a great deal of containing already going on. It's just we're not calling it that.

In sum, I think a lot is made of Chinese soft power in the region, but in truth, I think this is a kind of a shallow debate. If the United States truly engaged at the level, especially with the young democracies and the older democracies that have problems of corruption, which have problems of governance, it's not China that will be able to fill in and lead and help them with their biggest problems. It's the United States if it engages along this dimension.

Thank you. I'll be happy to take questions.

[The statement follows:]

**Prepared Statement of Daniel Blumenthal
Resident Fellow, The American Enterprise Institute**

- I am honored to have the opportunity to appear before this distinguished Commission on this important topic—The impact of China's economic growth on North and Southeast Asia.

Specifically: How will China's economic growth serve as an economic catalyst for the rest of the region; how will it provide China with enhanced leverage? How is Chinese military power affecting the postures of other countries? How does the China-Taiwan relationship affect China's relationship with the region?

- I think the questions posed go to the heart of Chinese grand strategy: the harnessing of its resources and energies to achieve its national aspirations.
- And those aspirations are becoming clear: that is to emerge over time as the dominant power in Asia.
- China is going about this as one would expect from an emerging power—but one that has learned lessons from past emerging powers.
- There are three elements to China's strategy:
- First, is to build up what it calls "comprehensive national power;"
- Second is to reassure the region that it in fact does not have revisionist or aggressive aspirations;
- Third, by necessity, is to displace the United States as the preeminent power, hopefully, in their minds, peacefully.

Much of what China is doing in Asia can be seen in the context of these three goals.

I. *Comprehensive National Power*

- The goal here is to develop all elements of CNP in unison. Economic growth is critical, but at the same time so is military power and so is building political leverage through economic growth and exchange.
- For Chinese strategists a critical piece of comprehensive national power is “peaceful reunification of the motherland” or holding together the multiethnic empire and bringing other territories “lost” during the “century of humiliation” back into the fold.
- Here is where Taiwan becomes such a high priority for China. The breakup of the Chinese empire—in China’s terms—has weakened it. To gain great power status it must reverse this and acquire Taiwan.
- Much of China military strategy, at least in the short term, is meant to intimidate, coerce, or use force to compel Taiwan to come into the fold. On the other hand Beijing is quite deliberately creating an economic interdependency that it hopes will convince Taiwan’s public to join the “motherland” again on the other hand.
- Economic growth is part of comprehensive national power and keeping relations with the United States and other export markets stable is thus a necessity, at least for now.
- The need for growth explains the tremendous amount of economic engagement China has developed with the region, and the institutions, the ASEAN–FTA, bilateral FTAs through which that engagement occurs. (Imports from Asia up 31%, volume up 36.5% to around \$495 billion in 2003).
- On balance Asian nations have benefited from trade with China. Although some sectors have been harmed.

They have found a reliable buyer for their natural resources and many Southeast Asian nations enjoy a sizeable trade surplus with Beijing.

Of course some sectors have done better than others: there is apprehension as to the consequences of allowing cheap Chinese agricultural products unrestricted access. One quick example:

After Thailand redrew its agreement with China on fruits and vegetables, for example, Chinese garlic was selling for the equivalent of 15 cents, whereas Thai garlic was \$1.35.

Growth is one driver of Chinese engagement.

- But there is no doubt that China sees its economic relationships in Asia in strategic terms as well—as a means to influence governments politically.
- Taiwan is the most glaring example of this—Taiwan’s exports to China account for 24.5% of its total now. And there are hundreds of thousands of Taiwanese businessmen living in China. China encouraged Taiwanese businessmen to fly to Taiwan in the 2004 Presidential elections to vote for the more pro-China pan Blue candidate.

And, China tries to use them to affect Taiwanese politics. As Phil Saunders at NDU points out—China encouraged Taiwanese businessmen to fly to Taiwan in the 2004 Presidential elections to vote for the more pro-China pan Blue candidate.

But other countries feel the pressure as well:

- I will give one quick example—Australian-Chinese trade has increased dramatically, more than quadrupling in the past decade, making China both the second most popular source of Australian imports and second most popular destination of Australian exports. Not coincidentally China has attempted to apply political pressure to change Canberra’s attitude toward the alliance with the United States.

In March of this year, He Yafei, a senior Chinese diplomat and Director-general of North American and Oceania Affairs, demanded of his Australian counterparts that they “re-look” the over 50 year old ANZUS treaty and make sure it does not apply to Taiwan.

Even Japan—where relations have soured and are quite competitive—China hopes over time to reverse the effects of an enhanced relationship with the U.S. by continuing a strong economic relationship with Japan Inc. Here it has to be more targeted—focusing on industries such as automobile that want to enhance market share in China.

- And, China is clearly targeting for economic and military aid and exchange countries that it defines as strategically important for reasons of energy security, for example, Burma, Cambodia and Thailand are particularly important as they sit astride key sea lanes.

- Beijing does not trust the U.S. Navy to ensure safe passage of its oil imports from the Gulf—so it is trying to mitigate its vulnerabilities.
- Burma could provide China with an overland alternative through the choke point of the Malacca Straits. Thus Burma has been the recipient of over \$1.6 billion in military assistance and \$200 million in economic assistance from the PRC in recent years.

Cambodia is also an important example of this—China has cancelled Cambodia's debt, donated military facilities.

Much of this is in pursuit of securing Cambodia's cooperation in transforming the Mekong into a major transportation artery for oil from or shipped through Thailand.

Thailand is also targeted as part of China's energy security strategy. Beijing and Thailand plan to construct an Energy Land Bridge linking the Andaman Sea with the Gulf of Thailand south of the Isthmus of Kra, and reduce the PRC's dependence on American-patrolled SLOCs.

In this case, the grease that got the wheels turning was Chinese financial assistance in the wake of the AFC in 1997 and 98. In short, both demonstrate both the scope of Chinese objectives and the persistence with which it is pursuing them.

II. Reassuring the Region

- David Shambaugh of George Washington has written eloquently about Chinese new found fondness for multilateralism in Asia.
- China, he writes, is increasingly involved in regional organizations and dialogues particularly Association of Southeast Asian nations (ASEAN) plus 1 and plus 3, the ASEAN Regional Forum and the Shanghai Cooperation Forum. Beijing has a particular fondness for fora that exclude the U.S.

Here is a Chinese official on the Chinese attitude toward regional fora—“Taking ASEAN plus 3 and the SCO as two focal points, China will make efforts to set up regional cooperation and push for the establishment of a regional cooperation conforming to the characteristic of regional diversity. . . .”

- China is pushing for a Free Trade Area in East Asia, and an East Asia Community, political, security and economic dimensions.
- While China continues its ambitious military modernization program—according to latest Pentagon reporting it could be spending up to 90 billion dollars on defense—making it the third largest spender in the world—it is at the same time working to reassure the region that its intentions are peaceful, that its military is solely focused on “preventing Taiwan independence” and that Taiwan is the problem.

Besides its active participation to ASEAN and EAC, Beijing is also conducting security dialogues with Australia, Thailand, Mongolia, engaging in mil-to-mil or defense sales with Cambodia, the Philippines and putting much energy into the ARF.

- In my view, China has not all of a sudden adopted a European allergy to hard power and the use of force, it is meant to reassure, until China is more confident of its hard power.

III. Gradually Displacing the United States

This is where the other two pillars of the strategy come together.

- Simply put, if China grows strong enough, and if it successfully reassures the region successfully thus preventing balancing coalition does form, it may not have to directly confront the U.S. with force.
- To be successful in this endeavor China must also break and fray Washington's alliances.
- Here we should also pay special attention to the *nature* of China's military build-up.
- As the recent DoD report has pointed out, the focal point of China's military build-up, ballistic and cruise missiles, as well as destroyers and submarines are mobile and can be deployed for purposes other than Taiwan.

The basis of regional security for decades has been U.S. defense commitments to Japan, to Taiwan, to Australia, Philippines and South Korea Thailand.

- The introduction by China of ballistic missiles, submarines, and fourth generation aircraft—what is called anti-access/sea denial capabilities—is meant to call into question the credibility of the U.S. commitments to its allies and friends.
- This is compounded by a growing and more credible intercontinental ballistic missile and nuclear threat. The idea is to put doubts in the minds of allies about the U.S. will and ability to continue to provide the region with security.

- In China's view, a level of military capability which it is not far from attaining, combined with successful leadership in regional fora that excludes the United States—ASEAN, the East Asia Community—will persuade nations to accommodate themselves to Chinese predominance and force them to re-think their partnerships and alliances with the U.S.

There is another way to break alliances—and here I turn to the Korean peninsula. Whatever the short-term outcome, the long-term goal for China is to get South Korea to question the need or value of the alliance with Washington. The hope in China, I think, is that once the ROK-U.S. alliance diminishes, then Japan is left isolated, as the only Asian country home to substantial U.S. troops.

Conclusions

- Now the question is how well is this strategy working. And here I must say it is mixed.
- The Taiwan issue in particular poses a conundrum from China—how can you on the one hand convey the message of a peaceful rise but on the other very publicly threaten Taiwan and build up your military capabilities?
- There are some examples of irritation by Asian nations with Chinese pressure on the Taiwan issue. Singapore was quite angered by Chinese bullying when now Prime Minister Lee Hsien Loong visited Taiwan in July 2004.

Even the South Koreans got their backs up when parliamentarians were told not to go to the Taiwan Presidential inauguration in 2004.

Nations of the region do not want a conflict between the U.S. and China over Taiwan but they do not want the U.S. to cede Taiwan either—they would view that as a real blow, they would really question the value of U.S. commitments.

- And, I would add that it has not gone unnoticed by nations of the region—Japan, in particular but others as well—that the same weaponry that China is deploying opposite Taiwan can be used to make good Chinese territorial and resource claims in the sea of Japan and in the South China sea (C4ISR, space based, over the horizon, aerial refueling, AWACS).

Remember it was only about a decade ago that China forcefully took Mischief Reef—territory claimed by Manila as well as China.

Remember as well that the relationship developed only when Southeast Asia secured China's agreement to meet two conditions: stop pushing SEA to drop U.S. alliances, and refrain from politically mobilizing overseas Chinese. There still exists a fundamental distrust that hasn't been displaced by economic exchange.

- So what are these countries doing? Well clearly Japan is balancing—the adjustment to its defense posture I would argue is more about China than North Korea.
- A Vietnamese Prime Minister was just in town for the first time since the war to discuss among other things defense and intelligence cooperation.
- The U.S.-Singapore defense relationship has been upgraded with the recent signing of the Strategic Framework Agreement, and the U.S. Navy now pays more than one hundred ship visits there each year.
- The U.S.-Australia relationship has been upgraded and there will now be a trilateral dialogue among the foreign ministers of Washington, Tokyo and Canberra.
- The India security relationship which you will here more about later is upgraded.
- The bottom line is that nations of the region are reacting, and are quite certain that the military build-up is not just about Taiwan.
- If you look at statistics provided by Strategic Asia—you see that military expenditures by India, South Korea, Australia, Indonesia have all gone up in dollar amounts.
- And in particular, South Korea, Singapore, Australia and Japan are all undertaking significant military modernization programs—most with the intention of interoperating with the U.S.
- Containment is a loaded term, but there is actually a good deal of containing already going on, although nobody, including the U.S.G., wants to admit it.
- Let me add a final point that gets into policy prescriptions. There is much talk about Chinese advantages on “soft power,” they are not as bullying as the United States, many students now study in China and so forth, and this is all true.
- But, I would like to direct the Commissioner's attention to something else—the Journal of Democracy recently published a fascinating study of democracy in Asia done by the *East Asian Barometer Survey Project*.

- And they interviewed publics in new democracies and older democracies—South Korea, Japan, Mongolia, the Philippines and Taiwan and Thailand.
- I will distill it down to this—vast majorities in all of these countries preferred democracy to any other system and wanted it to work in their countries. It was mixed especially in the younger ones to whether they thought it would sustain. But they unquestionably wanted it to.
- Now, is China going to help these countries with democratic consolidation? Their corruption problems and so forth. The answer is of course no.
- Only America can lead the way on this issue. And, if we engage along this dimension believe the notion that China has a soft power advantage will disappear quite quickly.
- The bottom line is to be clear with the Chinese that we are not going anywhere, that our presence has been the *sin qua non* for peace, prosperity and democratization in the region.
- And, there should not be a China exception to the President's assertive promotion of democracy. I believe that only if China becomes one will the U.S. and China be able to work out a peaceful accommodation in Asia. If you listen to many Chinese people the idea is not so farfetched.

Thank you.

Cochair TEUFEL DREYER. Thank you very much, Mr. Blumenthal. Our next speaker is Dr. Michael Chinworth. He is Director of the Center for U.S.-Japan Studies and Cooperation at Vanderbilt University's Washington Office.

Dr. Chinworth.

**STATEMENT OF MICHAEL W. CHINWORTH
DIRECTOR, WASHINGTON OFFICE
U.S.-JAPAN CENTER FOR STUDIES AND COOPERATION
VANDERBILT UNIVERSITY**

Dr. CHINWORTH. Thank you very much. Good morning, ladies and gentlemen. It's a pleasure to be here. It's an honor to be here. Thank you for this opportunity to address the Commission. I am the Director of the Washington Office of the U.S.-Japan Center for Studies and Cooperation at Vanderbilt University.

My boss is Dr. James E. Auer, the founder of the center 16 years ago after he left the Defense Department after a long career there. Although today's topic is China's impact on the Asian Pacific Region, I will probably return to the theme of U.S.-Japan bilateral relations continuously because I believe that relationship to be central to balancing potentially competing interests in the region.

China's vast potential economically, militarily, politically has been documented in other hearings held by this Commission. Assessing the impact of this potential is difficult, in my view, in part because Chinese long-term objectives and tactics are not fully understood.

Some objectives are certain. There's no doubt, for example, that China seeks to incorporate Taiwan peacefully or forcefully. Questions do abound in my mind, however, concerning its military, political or economic tactics for achieving this aim.

Given these doubts, it's often difficult to ascertain whether China's potential is benevolent, malevolent or benign. Let's look, for example, at economic growth. Global economic growth rates are expected to average annually between 2.8 and 2.9 percent for the next ten to 20 years. Growth in East Asian nations is probably going to be double that, and of course China is leading the way within the East Asian nations.

China's annual growth rates over the 2000–2010 period is expected to reach 6.6 percent on average. The following ten years, it's supposed to average five, 5.5 percent annually. Now, these growth rates have led to considerable changes in the region already.

Mr. Blumenthal mentioned reallocation of global production in the region. China's low cost production has encouraged relocation of manufacturing capacity, leading to long-term concerns over the competitiveness of other nations, over a potential hollowing out of industries within Asia and across the world.

On a similar front, there's been concern about the long-term impact of this economic growth on science and technology capabilities within nations. If regional growth rates are not sustained, then countries cannot continue to invest in science and technology and cannot be competitive against China.

There is no doubt in my mind that China presents some very serious competitive challenges to the United States and other nations. At the same time, however, there are noticeable benefits for the region. One demonstrable result of these growth trends has been greater economic interdependence among nations in the region.

For example, just taking one category randomly, total general machinery exports among China, Japan and the four top ASEAN economies in the region equaled about \$30 billion in 1990, and Japan's share accounted for 86 percent of those total exports.

By 2001, total exports in this same category among those same countries reached \$76.4 billion with China and leading ASEAN economies accounting now for 18.3 and 28.8 percent of that total respectively.

Now, total trade and production in this category would suggest beneficial things: integration of the region, economic expansion. Both of these are desirable. At least that's what my college textbooks told me in freshmen year economics. These are good trends. Japan has been party to this expansion and other nations have been as well, but again, there are these concerns that over time all these nations will lose their competitive advantage, especially in high tech/high value added industries as China expands.

Let's look again at the R&D effects of these trends. I would argue that in fact there may be a stimulating effect by China in R&D policies, science and technology policies in the region. If you look at many of the trends within the region, you're actually seeing something of a mini-boom regionally. Using many indicators, there are increased outputs among nations in this region in science and technology.

For example, research and development funding for many nations has increased including South Korea and China. The number of science graduates is increasing with growing numbers graduating now from local universities and not the United States. This would imply that local education opportunities in science and technology are now viewed as competitive with those that are offered in the United States.

There's evidence of increased citations of Asian authors in international technical journals and co-authored international papers. Patenting activities have boomed, especially by South Korea and China, and that's both domestically and internationally.

All of this suggests a very robust effort to improve the quality and quantity of science and industrial research throughout Asia. Japan's case offers a more mixed picture. Its spending has increased, but private sector investment is absolutely critical to its long-term growth. Private sector investment has been damaged seriously by the economic stagnation of the last decade.

That trend, I think, could be continuing with the country for some time, but it's primarily of Japan's own making. Its economic policies have encouraged some restructuring especially in the financial sector, but it has not been complete, and I would argue that until its reform is implemented completely, other influences in the region will have a marginal effect on Japan's real ability to compete regionally and globally.

These nations are in many respects predisposed towards science and technology improvements as stimulants of economic growth. When you add in the China factor and its own growth, then I would argue that these nations will respond in kind. They will accelerate their efforts and so far the indicators are that they're accelerating successfully, and of course that means more competition for everybody—the United States, Japan and China.

How will this play out? Well, I'm not going to make a forecast for 20 years, but right now it's clearly a mixed picture, but there are beneficial aspects to all this.

The damper on this, of course, is Chinese military buildup. Much of the economic promise of China contrasts sharply with concerns over its military buildup. I share those concerns. China's military modernization in my view is aimed at assuring its freedom of will with regard to Taiwan and other territorial issues in its immediate area.

As we know, this is very troublesome to the United States and its allies such as Japan because China has not renounced the use of force in incorporating Taiwan. Uncertainties over China's intentions make its modernization problematic to the United States and Japan.

The Japanese government has refrained from calling this a threat, but they say it's something to keep an eye on. It's worrisome. It's potentially a problem. But at this stage, I would say that China's military modernization does not pose a direct threat to the United States, to U.S. assets in the region, or to Japan, but again, the uncertainty of China's intentions and directions causes both countries considerable concern.

The buildup is clearly aimed at increasing its influence regionally and particularly at the ability of the United States to influence relations with Taiwan. China's short and long-term plans for projecting that increased military capability to actively force Taiwanese incorporation are less certain in my mind.

Cochair TEUFEL DREYER. Could you sum up, please?

Dr. CHINWORTH. I would sum up by saying that the critical factors from my perspective are a continued and robust U.S.-Japan security, economic, political relationship. That to me is the core to stability in Asia. I would also say that we need to be careful about straightlining current trends out into the future. Nothing continues forever; all of China's elements of its economic and political strategy are not predestined to succeed. All of its acquisitions in the pri-

vate sector, for example—its merger and acquisition activity—they're not predestined to succeed so I would not necessarily get concerned about current activities or try to draw conclusions for 20 years out based on current trends.

Again, in my view, the real key is the security relationship between the United States and Japan, the robust economic activity between those two countries. I would look at how trends affect U.S.-Japanese engagement in the region across a long, a broad range of issues. Thank you very much. I would be glad to entertain questions.

[The statement follows:]

**Prepared Statement of Michael W. Chinworth
Director, Washington Office
U.S.-Japan Center for Studies and Cooperation, Vanderbilt University**

Good morning, ladies and gentlemen. Thank you for this opportunity to address the Commission. I am Director of the Washington Office of Vanderbilt University's U.S.-Japan Center for Studies and Cooperation. The Center was established sixteen years ago by Dr. James E. Auer after his retirement from the Department of Defense. Our purpose is to promote continued, strong ties between these two strategically important nations. Although the topic of today's session is China's impact on the Asia-Pacific region, I will return to the theme of U.S.-Japan bilateral relations regularly because I believe that relationship to be central to balancing potentially competing interests in the region.

China's vast potential has been documented in other hearings held by this Commission. Assessing the impact of this potential is difficult in part because Chinese long-term objectives and tactics are not fully understood. Some objectives are certain. There is no doubt, for example, that China seeks to incorporate Taiwan peacefully or forcefully. Questions abound, however, concerning its military, political and economic tactics for achieving this aim. Given these doubts, it often is difficult to ascertain whether many elements of China's potential are benevolent, malevolent or benign.

China's Economic Growth and Regional Influence

The sheer scale of China's potential is certain to result in regional and global adjustments but their extent and nature are difficult to forecast. Consider the impact of Chinese economic growth. World economic growth rates are expected to average between 2.8 ~ 2.9% for the next ten to twenty years. Growth among East Asian nations as a group is expected to be on average twice that rate. Some forecasts anticipate average annual growth rates for East Asia of 6.8% in the decade from 2000 to 2010 and a still robust 5.5% rate in the following decade. China's growth rates over the same ten-year periods are forecast to be 6.6% and 5.5%, respectively.

Recent growth rates have resulted in shifting global production in several industries. China's low-cost production has encouraged relocation of manufacturing capacity, leading to long-term concerns over the competitiveness of nations dependent on that regional growth for their own prosperity. There are concerns about hollowing out of manufacturing industries as more production moves to China. With reduced industrial production and presumably profits, questions arise as to whether nations in the region will be able to sustain research and development investments to assure their long-term economic survival.

There is no doubt that China's economic growth presents serious competitive challenges to the United States and other nations. At the same time, however, there are noticeable benefits for many in the region. One demonstrable result of these growth trends has been greater economic interdependency among Asian nations. For example, total general machinery exports among Japan, China and the top four ASEAN economies equaled \$29.5 billion in 1990—with Japan's exports accounting for 86% of the total. By 2001, total exports in this same category among these same nations reached \$76.4 billion, with China and the leading ASEAN economies accounting for 18.3% and 28.8% of that total, respectively.

Total production and trade in this category suggests regional economic expansion and integration, both of which are desirable. Japan has been party to this expansion, but concerns within the country remain that the long-term trend will be expanded Chinese manufacturing at the expense of Japan's exports, including high technology industries in which it may currently have competitive advantages.

There are additional concerns that this will erode the ability of nations in the area to invest in future technologies to assure their competitiveness. By many measures, however, there is something of a regional science and technology boom, with some exceptions in the case of Japan.

For example, research and development funding for many Asian nations has increased, including South Korea and China. The number of science graduates is increasing—with increasing numbers graduating now from local universities than from institutions in the United States. This would imply that local educational opportunities are viewed as competitive with those offered in the United States. There is evidence of increased citations of Asian authors in international technical journals and co-authored international papers. Patenting activities both domestically and globally are notable, again with South Korea and China standing out.

All this suggests a robust effort to improve the quality and quantity of scientific and industrial research throughout Asia. Japan's case offers a more mixed picture. Research and development spending are showing signs of recovery but there are possible weaknesses in other areas. For example, private sector research and development spending is central to Japanese innovation. Continued economic stagnation throughout the 1990s, however, led to a decline in Japanese corporate R&D expenditures from 1991 through 1994. While absolute spending has increased gradually since then, the rate of increase has been modest and far lower than the rate of increase seen in the 1980s.

These apparent trends suggest that there is a general emphasis throughout the region on fostering indigenous science and technology as sources of economic growth. In part this comes as a response to perceptions that economic growth in Japan through the 1980s and U.S. economic revival in the 1990s resulted at least in part from successful innovation policies. There is further recognition of the importance of science and technology to sustain regional and global competitiveness.

China's science and technology advances are equally significant. It can be expected that domestic capabilities will rise rapidly with its industrial growth, injection of foreign know-how, and increased access to technical resources globally.

Rather than depressing regional growth, China's increasing science and technology capabilities may be having a stimulating effect on other nations. These nations recognize the importance of science and technology to their own domestic growth and international competitiveness. The importance of continued improvements is even greater given China's advances.

China's growth strategy certainly will be one factor influencing Japan's future R&D expenditures. However, the drop in R&D spending that Japan witnessed beginning in the 1990s developed from domestic economic and financial problems, many of them structural which linger today. Japan will be unable to respond to any external competitive challenge without addressing these issues. Japan's economy will still face formidable challenges regardless of the relative growth of China or other nations.

China's Military Buildup

Any economic promise of China contrasts sharply with concerns over its military buildup. China's military modernization, in my view, is aimed at assuring its freedom of will with regard to Taiwan and other territorial issues in its immediate area. As we all are aware, this is troublesome to the United States and its allies in the region because China has not renounced the use of force in incorporating Taiwan. Uncertainties over China's intentions make its modernization programs problematic to the United States and Japan.

The Japan Defense Agency officially calls for caution in interpreting these trends. The government is not inclined to label China a military threat but remains leery over the military intentions of the People's Republic. Maintaining a security balance in the region—particularly in the Taiwan Straits—is one of the most important security challenges facing the United States and Japan regionally.

Impact on U.S.-Japan Relationship

At this point, China's military modernization does not pose a direct threat to Japan or to U.S. assets in the region. The uncertainty of China's intentions and directions certainly causes Japan the most concern. The military buildup clearly is aimed at increasing its influence regionally, particularly in the ability of the United States to influence relations with Taiwan. China's short- and long-term plans for projecting that increased military capability actively to force Taiwanese incorporation are less certain.

Japan views this buildup with caution, not rushing to identify the country as a direct military threat, but not willing to disregard the scale of China's buildup and its potential impact.

The U.S.-Japan security relationship has been critical to both countries and the region as a whole in assuring stability. The importance of that relationship will increase as China's military modernization continues. The bilateral security relationship protects the individual and collective interests of the United States and Japan and will continue to do so for the foreseeable future.

My sense, however, is that a vague discomfort may exist in some Japanese business and government circles regarding China's rising economic, political and military role in the region. With China's economy assuming greater importance to Japan, I wonder if some in Japan fear the possibility that they will be forced essentially to make a choice between China and the United States to assure its own economic and perhaps territorial security. For a country that often views its own security in economic terms, the question is whether the value of Japan's economic ties with China—or its economic dependence on China—will some day outweigh the benefits of its economic and military relationship with the United States.

I offer this observation as a result of discussions that took place recently during a forum on U.S.-Japan security, hosted by our Center. Our Center hosts a bilateral security forum annually in which Japanese and U.S. business leaders exchange views on policy trends and emerging technologies. This year's session included a discussion of China's influence on the region and the bilateral relationship.

Participants agreed that the conflicting potential presented by China is more complex than that perceived from the former Soviet Union. The Soviet Union did not pose the same potential divisiveness to the U.S.-Japan bilateral security relationship. Nor, in the view of the participants, did the former Soviet Union demonstrate the same level of diplomatic sophistication in pursuing its regional economic and security objectives.

Participants agreed in principle that economic integration is desirable and that China's economic importance cannot be denied. Most were concerned, however, of formal mechanisms that would make U.S.-Japan bilateral interests subservient to a regional economic framework. One participant noted that while Japan does not necessarily view China as a military threat, its rising influence is something the Japan Defense Agency must "keep an eye on," implying that Japan must not promote economic integration hastily despite the clear need to engage in the region to assure its own economic growth.

The consensus of participants at our forum was that bilateral discussions on regional economic integration are warranted, but that comprehensive frameworks remain second to more targeted policy actions aimed at promoting that end. What is significant, however, is that one would not have expected such a discussion at all just a few years ago.

At this point, there is no indication that the Japanese government feels any need to distance itself from the United States. I would argue that, in fact, relations are stronger in many ways than ever before. However, with both our countries facing the mixed potential of China, we must recommit ourselves to continued, strong ties to assure fulfillment of our own interests in the region.

Limits on Chinese Influence

Forecasting always is as much art as science. One routine problem with predicting the future is that patterns and conditions change. In examining the potential influence of China in the future, it is important not to assume that current trends will continue indefinitely. Economic growth for any nation can slow or recede. Military capabilities can fluctuate. This is as true for China as it is for any other nation.

Recall that there was concern over Japanese military and economic resurgence—if not dominance—just twenty plus years ago, just as many Europeans feared domination by the United States twenty years prior to that. China presents different potential and far greater uncertainty, but the basic lesson of the past is that we should avoid drawing too many conclusions from current trends in anticipating the future.

Total success of all China's current efforts cannot be assumed. It is far from inevitable that all its visible mergers or acquisitions will succeed. Nor can we assume that its military modernization will continue infinitely or that it will be completely successful in all respects. Even with prudent regard toward China, it cannot be assumed that U.S. capabilities will stagnate in the face of its growing military forces.

Historical animosities within the region toward China also will pose a barrier to its efforts to exert its influence regionally. Nations in the region recognize that China cannot simply be ignored. They recognize the potential benefits of China's economic growth to their own economies as well. However, long-term concerns suggest that these countries also pursue relationships that will provide them economic and political alternatives as well as productive integration of China and other regional economies.

Lastly, although concerns over China may be legitimate, countries in the region must not neglect domestic initiatives that are equally critical to their long-term prosperity. One example is Japan's financial sector restructuring. While progress has been made in reducing non-performing loans among major lenders, this remains in my view one of the most significant threats to Japan for the foreseeable future. The financial sector has been one of the most important causes for Japan's declining competitiveness and stagnant economic growth over the last decade. Although improved, the situation remains serious. It is doubtful in my mind that Japan can return to significant growth rates consistently until it is fully resolved. I would add that a Japanese analyst most likely would make a similar observation for certain aspects of the U.S. economy.

At a bilateral level, the United States and Japan also have a sound security relationship that will remain critical to each country and to the region as a whole. Continued strengthening of this relationship is well within the ability of policymakers in both nations and would serve to dampen any potential threat posed by a Chinese military buildup. There are several steps that can be taken to further integrate operations of the armed forces of both Japan and the United States. These include increased interoperability of equipment used by the forces of both countries—particularly for next generation defensive systems now being considered by the Defense Department and the Japan Defense Agency—and new defense business models and forms of cooperation that would integrate the respective defense industrial bases.

For now, I would be reluctant to embrace China's emergence without question or to attempt to deny its reality. Caution in both economic and security policies remains prudent to assure that China's emergence brings benefits to other nations in the region and minimizes potentially disruptive influences.

Thank you.

Cochair TEUFEL DREYER. Thank you, Dr. Chinworth. Our next witness is Dr. Marvin Ott, who is Professor of National Security Policy at the National Defense University and has formerly served in the intelligence community. He is the author of many books and book chapters and articles on East Asia.

Dr. Ott, welcome.

**STATEMENT OF MARVIN C. OTT
PROFESSOR, NATIONAL SECURITY POLICY
NATIONAL WAR COLLEGE OF THE NATIONAL DEFENSE UNIVERSITY**

Dr. OTT. Thank you and my thanks to the Commission for this opportunity. Our time is obviously extremely short and I tried to keep my written presentation fairly succinct, but it's not nearly succinct enough for five or six minutes here. So let me use the little time I have, rather than speaking from that text, to try to draw what is basically a geopolitical portrait of what I think the relationship is between China and Southeast Asia. At the end of the day, my principle concern with the nature of that portrait is where it leaves U.S. policy and the U.S. strategic response, which I think has been, as I indicated in the testimony, and as I will repeat here, lacking in both intellectual content and policy resolve.

The portrait in very brief outline begins with Southeast Asia, a region that has enjoyed over more than three decades extraordinary economic success, modernization, transformation, of a kind that the Economist magazine in the mid-1990s said was the most extraordinary single thing to happen in the entire 20th century. Never in human history had so many had their living standards raised so fast across such a spectrum of society and the economy.

Having said that, the current picture in Southeast Asia is somewhat more difficult and tenuous. We still have the reverberations from the Asian financial crisis and meltdown of the late 1990s. That had the effect of bringing down the Suharto 32 year authoritarian dictatorship and throwing the future of Indonesia both eco-

nomically and politically very much into question. We are still playing that out, though the recent election of President Yudhoyono, the first popularly elected president in the history of Indonesia, is certainly an extraordinarily positive development.

But we've had, I think it's fair to say, a decline, a shaking of the coherence and effectiveness of ASEAN, the institutional framework developed by the Southeast Asian states for dispute settlement and diplomatic coordination amongst themselves. Most dramatically we've had the emergence of a major terrorist threat, honest-to-God-al Qaeda affiliated terrorist networks, jihadist networks that stretch from southern Thailand down through Malaysia, Singapore, centered in Indonesia and up into the southern Philippines, the Muslim populated swatch of southeast Asia.

Back to my geopolitical portrait—my reason for noting all of this is to assert that we have in my judgment, not a classic power vacuum in the classic realpolitik sense, but we have a region that is geopolitically vulnerable and shaken. This would have little significance were it not for the fact that on Southeast Asia's northern boundary, we have the emergence of China with growing and strengthening capability that you're familiar with. I would tend to echo Dan Blumenthal's characterization of it so I won't try to go into any detail at all.

Suffice it to say that since Deng Xiaoping replaced Mao Zedong and the Maoist radical program was basically discarded and replaced by a modernization development program, China has gone from the Maoist slogans to the more traditional Chinese aphorisms, rich country/strong army. China is now animated by nationalism. It is now feeling the strength to make that nationalism real in its immediate environment.

It is also freed from the traditional strategic threats presented by Japan and Russia and in my judgment that makes China for the first time since the height of the Ming Dynasty strategically free to begin to assert itself internationally.

We've talked about Taiwan. I'll leave that one aside. It's obviously the first item on the Chinese agenda, but in my judgment the next item is Southeast Asia, and these of course run concurrently. Southeast Asia has from the Chinese standpoint many virtues. It is proximate. It has large Chinese populations that are economically powerful. It is rich. It is vulnerable.

Chinese diplomats actually use the phrase "soft underbelly," the Churchillian phrase, to refer to Southeast Asia. This is the Nanyang, the South Seas, in traditional Chinese parlance "the golden lands." We don't have time for detail, but suffice it to say, and I'll echo Dan, the Chinese have put in place a very sophisticated diplomatic strategy designed to present a benign face to Chinese power with the ultimate objective in my judgment, and I do not have the minutes of the Standing Committee of the Politburo to prove this, but in my judgment, to make of Southeast Asia a traditional sphere of influence.

The Chinese regime is in many ways a very old-fashioned government. Think late 19th century Europe, Bismarck, that era. These are people who think in terms of power and interests and sovereignty and balance of power and spheres of influence and boundaries and territorial control, all that traditional good stuff

that made up the foundations of realpolitik in late 19th century Europe. That's basically gone now from Europe.

But it's very much alive and well in Beijing. It's alive and well in Singapore. It's alive and well in a number of parts of East Asia, and that's the way I think the Chinese see the world. Mike used a phrase "malevolent" or "benign" to describe intention on the part of the Chinese. Those are words that carry with them a moral category—a normative judgment. Instead, I see this, I hope, in fairly dispassionate terms. I think it is geopolitical. It is realpolitik.

What the Chinese are doing and their ambitions vis-à-vis Southeast Asia—there is nothing illegitimate about it in my judgment. There is nothing surprising about it. It's not criminal. What this is is a rising great power, rising against a period of long humiliation, deeply felt, that is now determined to assert its place in the sun, and its place in the sun includes that Southeast Asia will become their "western hemisphere." This will be their Monroe Doctrine.

If Xerox wants to trade in the region, if Exxon wants to go for oil, if you want to send tourists, that's fine, but don't send your navy. This belongs to us. This will be our security monopoly. So I'll echo Dan again: the objective here is, and it's not easy, but the objective here is to marginalize and gradually displace American power and make this a region when, for example, the Thai prime minister has a significant policy initiative on his mind, his first phone call goes to the Chinese ambassador saying how will this fly in Beijing? If the answer is not well, then the policy initiative is never proposed.

I mentioned this a year and a half ago or so to a senior Thai diplomat and he smiled and said, "We're already there."

I'd like to wind up and I'm not sure whether my time allows, but I have it in my testimony, a comment on where the U.S. fits into this picture and I'll reduce it to 30 seconds worth and then I'll quit at that point.

Cochair TEUFEL DREYER. Thank you.

Dr. OTT. The United States is in the way. We sit astride sea-lanes, the Seventh Fleet, defense agreements, defense presence, access arrangements. We are in the way of this Chinese ambition. The result of this—I'll borrow a phrase from history—"the great game." That was used to refer to the contest for primacy in central, northern South Asia between Russia and Great Britain at the latter part, mid to late 19th century.

There is a new great game underway. It is a great game over the future of Southeast Asia and, by the way, the South China Sea, which the Chinese claim sovereign control over. This is not the Caribbean. This is Lake Michigan.

So these are the stakes of the game. One player in the game has already made several moves. They've been very carefully thought through. They've already gathered a number of chips to their side of the table. The other player is distracted, focused elsewhere, and hardly aware that the game has even started, and I'll be happy to elaborate on this. I think it's about time that the United States become aware that the game is underway.

It's a game we need to play. We are dealing with an opponent, and I'll say opponent rather than enemy or adversary, an opponent

that is very skilled, very determined, and has in fact a real strategy. We, in fact, we the United States do not have a strategy, and it's time that we had one.

[The statement follows:]

**Prepared Statement of Marvin C. Ott
Professor, National Security Policy
National War College of the National Defense University**

China's Strategic Reach Into Southeast Asia

Summary

China's geopolitical ambitions focus on Southeast Asia, where Beijing is intent upon establishing a preeminent sphere of influence. China has pursued this ambition with a very skilled diplomatic campaign designed to ultimately bind the region to China—politically, economically and militarily. This effort and the strategic vision that animates it have profound implications for U.S. security interests in East Asia and beyond. In effect, a contest for the future of Southeast Asia and the peripheral seas is already underway. Beijing has been astute with its early moves in this new "Great Game." Washington has been comparatively inattentive and inert. At a minimum, the situation calls for a better, more informed, understanding of the state of play.

Context

The dominant characteristic of Southeast Asia has been its rapid economic growth and modernization. Over the last three-plus decades, countries like Singapore, Malaysia, and Thailand and to a lesser extent the Philippines, Vietnam and Indonesia have been utterly transformed. Economic growth has quintupled per capita incomes in little more than a generation. Villages based on subsistence agriculture have been absorbed into modern cities. Along with this has come a degree of regional peace and security that is without historical precedent. The last inter-state military conflict came to an end in 1989 with the withdrawal of Vietnamese forces from Cambodia. Today, warfare between or among the ten Southeast Asian countries that make up ASEAN is not quite, but almost, as inconceivable as warfare within the EU. Peace and security are powerfully buttressed over the long term by the remarkable democratic transformation in Indonesia. Today the world's largest Muslim nation has a popularly-elected President. Altogether these are remarkable achievements.

This broadly positive picture is, however, fragile. Economic vulnerabilities were evident with the Asian financial crisis of 1997–8 that devastated the Thai, Malaysian and Indonesian economies. Recovery has been impressive but still tenuous—particularly in Indonesia. The security picture is more dramatic and troubling. Broadly speaking, the region faces two security challenges—neither of which was foreseen a decade ago.

- (1) Militant jihadist networks organized in the aftermath of the Afghan/Soviet conflict have become entrenched in the region. The core network is Jemaah Islamiyah centered in Java but with cells and support groups throughout Muslim Southeast Asia (S. Thailand, Malaysia, Indonesia, S. Philippines)—and with an Al Qaeda connection. JI came to the attention of U.S. and regional security services when a plot (with advanced operational planning) was uncovered to bomb multiple targets in Singapore. Subsequent bombings in Bali and Jakarta and the Philippines have given credibility to the JI threat. There has long been a militant fundamentalist element in Indonesian Islam embodied in a group called Darul Islam, but it has always been a marginal factor in the broader polity and society. Muslim radicals have become more capable and threatening thanks largely to infusions of Saudi money and clerics and to the catalyst of Afghanistan. In my judgment, however, we will see (and are beginning to see) counteractive measures from governments and societal organizations in Indonesia and elsewhere that will gradually circumscribe and control the militants. In short, I believe the jihadists will remain a significant security threat for a few more years but not longer. Chronic violent activity will continue to be associated with Muslim Moro separatism in the southern Philippines but the driver here is a sense of cultural separateness and economic grievance focused on Manila—not a global jihadist crusade. In time the Thai will find ways to build institutional bridges to the Muslim populations in their south sufficient to reduce the violence even as separatist sentiment continues to simmer.

- (2) China is mounting a strategic challenge to Southeast Asia and to the U.S. position in the region that is substantial and long term. An understanding of the Chinese challenge begins with an appreciation of the rapid, even spectacular, growth in Chinese power/capabilities since Deng Xiaoping began to dismantle the Maoist legacy in the late 1970s. Over most of the last 20 years the Chinese economy has been growing more rapidly than any in the world—about 9 percent per year in aggregate—with growth along the coast from Hainan to Shanghai averaging in double digits. This in turn has financed a growth in military budgets that has been even faster over the last decade. China's growing power coincides with a moment in history when Beijing is freed from the two historic threats that have kept China on the defensive—Russia and Japan. Neither poses a security threat to China today. This has freed China to look for strategic opportunity—for arenas where China's traditional greatness can be reasserted. The motive forces driving Chinese strategy are geopolitical ambition and nationalism. Maoism/Marxism is dead (confined to political rituals) and has been replaced with a strident nationalism most reminiscent of late 19th Europe. All of this is given a very sharp edge by China's acute sense of historic grievance against the West and Japan—opium wars, treaty ports, reduction to semi-colonial status, and military invasion. China's leaders (and populace) are determined to restore China's "place in the sun." In this regard it is useful to recall that over two millennia when Chinese dynasties were strong, the Middle Kingdom exerted a unique form of preeminence over neighboring lands that Western Sinologists have called the Tribute System. A modern analog to such a system would be an exclusive sphere-of-influence as opposed to a colonial or military occupation.

China's Agenda

The natural focus of China's strategic ambition is south toward Southeast Asia and the South China Sea—the "Nanyang" or southern seas; the "golden lands" in traditional Chinese parlance. Northeast Asia is a difficult and dangerous region where China is basically playing strategic defense—trying to prevent adverse developments like a North Korean collapse or a nuclear Japan. Southeast Asia by contrast offers opportunity, wealth, and vulnerability. Chinese diplomats actually use the Churchillian phrase "soft underbelly" to refer to this part of Asia. It is also a region with large, economically important populations of ethnic Chinese. There is little doubt that the leadership in Beijing seeks to establish a classic sphere of influence in which China has a security monopoly—a region where non-Chinese external military forces are excluded and where Beijing acts as regional arbiter on matters of high politics and strategy. Chinese strategists see Southeast Asia as the weak link in what they perceive as an emerging U.S. containment of China. Government-linked publications identify the region as the point where China can "break through" containment.

The issue of Taiwan plays into the Southeast Asian strategic environment in subtle and largely indirect ways. There is a great deal of unofficial sympathy for Taiwan among Southeast Asia's large ethnic Chinese populations. Given a choice between a communist or noncommunist government for China, there is no question that Southeast Asia's Chinese would choose the latter. Also Taiwan has a substantial economic presence as investor and trading partner throughout the region. At the official level, however, all Southeast Asian governments affirm a "one China" policy that conforms closely to Beijing's requirements—including full diplomatic relations with Beijing and non-recognition of Taipei. China jealously guards its diplomatic monopoly and is quick to condemn the slightest breach—as when senior Taiwanese officials attempt to travel to Southeast Asian countries on "private" visits. When Singapore's Prime Minister-designate, Lee Hsien Loong, visited Taiwan prior to his investiture, it produced an angry, threatening response from the Chinese government that clearly surprised and discomfited Singapore.

The Southeast Asian countries have managed the China/Taiwan issue much as other countries have. Formal diplomatic ties provide the framework for rapidly growing economic (and security) ties with Beijing. These coexist with robust commercial, financial, tourist and other nongovernmental interactions with Taiwan. This works so long as two conditions are met.

- (1) China refrains from trying to recruit Chinese populations in Southeast Asia as overt allies in its dispute with Taiwan. The effect of such an effort would be to politicize ethnic Chinese as Chinese—calling into question their status and loyalties as citizens of Thailand, Malaysia, the Philippines etc.

- (2) The cross-Straits dispute does not turn violent. Southeast Asian governments dread the prospect of being compelled to take sides, even politically, in a military confrontation between China and Taiwan.

Recent developments in Southeast Asia have created strategic opportunities. America's military center of gravity in the region—Clark air force base and Subic naval base in the Philippines—disappeared. ASEAN, so confident and vibrant in the mid-1990s, saw its coherence and international standing decline precipitously by the end of the decade. The same organization that seemed to face China down after the 1995 Mischief Reef confrontation was mute and ineffective when the issue reprised in 1998. The near collapse of Indonesia created, in strategic terms, a void where a cornerstone once had been. In short, the balance of power between China and Southeast Asia had shifted in Beijing's favor.

What exactly does China seek in Asia generally and Southeast Asia specifically? No one outside the Chinese leadership can answer that question with precision. We don't have the minutes of the Standing Committee of the Politburo meetings on this question. Moreover, different elements of the Chinese government—notably the Ministry of Foreign Affairs and the People's Liberation Army—have often conveyed rather different impressions to foreign counterparts. To some extent those differences are no doubt contrived to persuade and obfuscate. But they also may reflect a genuine lack of consensus in the senior leadership. Nevertheless, it is possible to identify a series of Chinese strategic objectives in general terms with some confidence.

First, China surely prefers a peaceful and prosperous Asia, one that will be a continuing source of trade and investment so critical to China's modernization. Moreover, such a benign environment will allow China to avoid the trap that the Soviet Union fell into—of allowing military expenditures to rise to the point that they undercut the economic and political viability of the state.

Second, China wants a sharp diminution in United States influence in Southeast Asia, especially in terms of its military deployments to the region and its encircling (from China's perspective) chain of bilateral security arrangements with many of China's neighbors.

Third, China seeks a Japan that is passive, defensive, and strategically neutered—one that has effectively withdrawn from the competition for power and influence in Asia. Almost by definition, such a Japan will resist being an instrument of American strategic designs.

Fourth, Beijing also seeks clear sovereign authority over the South China Sea, i.e., recognition of the sea as Chinese territory with international transit conducted under Chinese ground rules. In short, China is determined that the South China Sea will become, in time, a Chinese lake and will be accepted as such internationally.

Fifth, China expects that Southeast Asia will be progressively subordinated to Beijing's strategic interests. Perhaps the closest analogy would be the assertion, in time, of a kind of Chinese Monroe Doctrine for Southeast Asia. Such a strategy would seek to expel any non-Asian (and Japanese) military presence from the region and create a strategic environment in which Southeast Asian governments understood that they were not to make any major decisions affecting Chinese interests or the region without first consulting, and obtaining the approval of, Beijing. It is with this scenario in mind that several ASEAN governments have watched with concern China's growing influence in Burma and to a lesser extent in Laos and Cambodia.

Aspiration is one thing; implementation is another. Since the mid-1990's (post-Mischief Reef) China has pursued a beautifully conceived and operationally sophisticated strategy to extend Chinese influence into Southeast Asia. At its core it is designed to present a benign face to Chinese power—to convince the Southeast Asia states that China offers economic opportunity and diplomatic partnership. It has taken the form of a diplomatic charm offensive that has been institutionalized through a remarkable set of bilateral and multilateral (with ASEAN) agreements. The result is an increasingly dense web of arrangements that progressively bind the region to China. The most recent manifestation of this strategy is a Chinese proposal, accepted by ASEAN, for an annual ASEAN plus 3 *security* summit that would include Korea and Japan but exclude the U.S. and Australia. Southeast Asia has never had a viable regional security framework; China proposes to establish one led by Beijing. At the same time China has pursued nuanced strategies tailored to foster bilateral ties with each of the governments in the region. Beijing's success to date is evidenced by the fact that Burma, Cambodia, and Laos can be credibly identified as Chinese client states—generally pliant to Beijing's direction within ASEAN, for example. Thailand seems to be seeking a role as a favored agent/surrogate of

Beijing while avoiding full subordination. Economic development is another key element in China's strategy. For example, China has developed ambitious plans for the development and exploitation of the Mekong Basin beginning eight dams on the upper Mekong. China is working closely with the downstream states (Laos and Cambodia in particular) to integrate them into China's grand plan for the Mekong. All this has obvious strategic as well as economic implications.

At some point China's strategic ambitions will collide with America's established security presence (defense agreements, 7th Fleet deployments etc.) in the region. For China, the great challenge is finding ways to gradually marginalize the U.S. military by making the region progressively less hospitable. China and the U.S. are like two tectonic plates rubbing against one another and the faultline runs through Southeast Asia and the South China Sea. Put another way, there is a strategic contest (a "Great Game") underway and one player has developed a sophisticated strategy and has already collected a number of chips; the other player does not have a strategy and acts like it is unaware the game has started. So far, the U.S. is losing the game.

What Should be Done? A Proposed U.S. Strategy

The U.S. has effective policies (e.g. counterterrorism) and initiatives (e.g. tsunami relief) regarding Southeast Asia—but these do not add up to a security strategy. The absence of a strategy would be of little moment if the U.S. did not face a strategic challenge in the region. But it does.

The following are some preliminary thoughts—focusing on the China challenge—regarding a new American strategic approach to Southeast Asia. It is simply a list of proposed initiatives designed to kick start a process.

General:

- Systematically think through U.S. interests, goals and the challenges/threats to them.
- Assess U.S. resources and capabilities (including those that come through leveraging security partnerships in the region) relative to interests and threats.
- Formulate a strategy designed to maximize U.S. interests consistent with resource constraints.

Fundamental to this whole process will be a judgment as to what degree the U.S. is willing to accommodate the growth of Chinese power and influence in the region. For example, can the U.S. accept a Chinese sphere-of-influence that leaves the SLOCs recognized as international waterways not subject to Beijing's control?

Specifics:

- Clarify U.S. thinking regarding the SLOCs (Malacca Straits and South China Sea routes)—their status under international law, U.S. vital interests and what the U.S. is prepared to defend militarily if necessary. Provide authoritative prominent statements of the U.S. position to repair the current ambiguity on the public record.
- Propose/initiate a security dialogue with each of the Southeast Asia countries to be conducted at whatever level the counterpart government prefers. Make this a true dialogue in which the U.S. receives as well as transmits. This will be difficult to get going with a number of governments (e.g. Malaysia) and may begin as a secret interchange among intelligence professionals. But as it becomes established, such a dialogue will provide a vehicle for serious consultations regarding regional security issues and potential areas of collaboration. The payoff would come with a meeting of the minds concerning China.
- The tsunami relief effort rapidly took shape as a quadripartite operation involving Japan, Australia, India and the U.S. This was a remarkable success and suggests that these four countries might provide the sinews for a new multilateral security arrangement in Southeast Asia of a kind that has not heretofore existed. Initial potential missions include maritime security (counterterrorism, counter-piracy, environmental protection) and disaster mitigation and prevention. Any such initiatives would have to be carefully vetted with the governments of the region. These four countries have demonstrated their capability to provide critical "security services" to the region. The fact that China is not included because it currently lacks such capabilities is fortuitous.
- Task the CIA to conduct an extended collection and analysis effort aimed at understanding the full nature and extent of China's strategic reach into Southeast Asia. Done properly this will be a multiyear, perhaps multi-decade effort requiring the development of extensive assets that do not presently exist. For example, China has apparently put in place an extensive program of Chinese schools

in a number of Southeast Asian countries (e.g. Cambodia) which has gone almost entirely unnoticed by Western Intelligence agencies.

- Assist “think tanks” in the region to develop their analytical and personnel capabilities. At present the only Southeast Asian country with a critical mass of world class security strategists is Singapore. Incipient capabilities exist in Hanoi and Jakarta—and to a degree in Kuala Lumpur and Bangkok. Beijing has taken effective advantage of the lack of strategic sophistication in Southeast Asian capitals. It is in America’s interest to try to remedy this situation.
- Reassess policy toward Burma and consider the consequences for U.S. security interests of continued sanctions that effectively drive the Burmese junta into the arms of China.
- Task INR (State) to assess the strategic implications of China’s drive to harness and develop the Mekong. Private contractors working with the World Bank might be helpful in understanding the full import of what China is doing and possible U.S. counter-initiatives.

In addition to such regionally-oriented initiatives there are a companion set of bilateral initiatives that should be developed regarding U.S. policy/relations toward each individual country.

Chairman D’AMATO. Thank you very much, Dr. Ott, and our next speaker is Mr. Bronson Percival who is a Senior Advisor to the CNA Corporation where he specializes in South and Southeast Asia. Mr. Percival has served in the State Department’s Bureau of East Asian and Pacific Affairs and was from 1974 to 2002 a U.S. Foreign Service Officer. Mr. Percival.

**STATEMENT OF BRONSON E. PERCIVAL
SENIOR ADVISOR FOR SOUTHEAST ASIA
CENTER FOR STRATEGIC STUDIES, CNA CORPORATION**

Mr. PERCIVAL. Thank you very much for the opportunity to appear before the Commission. I too am going to focus very much on Southeast Asia, but I think I take a different view than Marvin. It seems to me that in Southeast Asia, China has sought, or at least what we can see, that China has sought several things. It’s sought to stabilize its southern periphery. It’s sought to convince Southeast Asians that it’s not a threat.

It’s sought to gradually isolate Taiwan and it’s sought to tap into Southeast Asian funds and resources to contribute to China’s economic modernization. At the same time, it portrays itself as an engine of growth for Southeast Asian economies.

I would argue that in most, but certainly not all Southeast Asian eyes, China has in the past decade transformed itself from a threat into a perceived partner. It has done this primarily through attentive and accommodating diplomatic leadership from the very top down.

Basically what the Chinese have done is they have reassured Southeast Asian elites of their support for the political and territorial status quo in Southeast Asia.

In addition, most Southeast Asians hope that China’s economic growth will also contribute to their own prosperity and there is indeed a booming trade relationship between China and Southeast Asia that may very shortly surpass the trade relationship between South Asia and the United States.

Now most Southeast Asian leaders are still wary of China, but they’re willing to accommodate a larger role for China as one of several external powers in their region. I do not agree at all that China’s reemergence signals the beginning of zero sum competition between the United States and China in the region.

China's rise in Southeast Asia has had a much more significant impact on Tokyo's status and influence in the region than on Washington's. Why? Well, I think there are many reasons. Tensions in the U.S.-China relationship whether its intellectual property rights, currency revaluation, Taiwan, trade deficits, have seldom spilled over into Southeast Asia.

Specific Chinese and American goals and interest in the region are seldom in direct conflict and Washington and Beijing bring very, very different strengths and weaknesses to their relationship.

Finally, Southeast Asians don't want to be caught in either an American or Chinese embrace. They want to avoid any strategic competition that may emerge between China and the United States.

China's ultimate intentions may be malign towards the region, but at this point they're unpredictable. For Southeast Asians, looking at it from a Southeast Asian perspective, there are potential problems for the relationship with China, mostly economic competition, China's energy requirements and avoiding being caught in increased tension between China and the United States.

One of the things I'd like to emphasize is that the tendency to treat the Southeast Asian region as a state or an economy really seriously distorts reality. Southeast Asia is among the world's most ethnically, politically and economically diverse regions. Many states in Southeast Asia think they can pick and choose amongst the various components of Chinese, American, Japanese and Indian influence.

Thailand, for example, has been famous for bending with the wind and doing exactly that. Not all states in Southeast Asia enjoy such flexibility. Burma and Vietnam don't for different reasons. Over the last decade, the Chinese have turned their approach to Southeast Asia on its head, and they have indeed come up with a comprehensive strategy, which is quite impressive.

The diplomatic side to it started out with normalizing relations. Now we're going into a East Asia Community Summit in Malaysia in December, which will exclude the United States.

Economics may be even more impressive because Southeast Asian economies and China are, in fact, competitive. They're competitive for FDI and for developed markets in Japan, Europe and the United States. Nonetheless, we're going to have a China ASEAN free trade area. Everybody knows China is trying to secure energy throughout the world. They're particularly active in doing so in Southeast Asia. I think you all know that two-thirds of Unocal's oil and gas reserves are in Southeast Asia.

As Beijing has linked itself into this diplomatic and economic network, it's narrowed its political goals in Southeast Asia. At the top of that list is Taiwan. The last thing any Southeast Asian country wants is to be dragged into a Chinese-U.S. confrontation over Taiwan, which may have implications for our forces in Singapore.

Beijing has allowed security relations to follow behind economic and diplomatic relations. To even get there, it had to come up with a code of conduct for the South China Sea and the disputes between China, Taiwan and four Southeast Asian countries. It has sought to chip away at American military dominance, but it's downplayed this since 2001 when Chinese-U.S. relations improved.

China has every reason to continue to try to downplay security in its relations with Southeast Asian countries and to portray China's rise as an economic rather than a security challenge.

Now, a number of people question how much influence China really has in Southeast Asia because it has so seldom sought to exert influence in Southeast Asia. They also question the relevance of image and perceptions and economics and much of what gets wrapped up into the term "soft power." Given the fuzziness of the term, I am very tempted to agree with Secretary of Defense Rumsfeld who has alleged to have claimed he didn't know what "soft power" was.

But, to dismiss China's economic and diplomatic influence by pointing to America's continued military dominance does little to meet Southeast Asian pleas for reassurance that Washington understands their priorities which are domestic, economic and political stability.

Finally, I'd like to say the United States remains very much entrenched in Southeast Asia, both militarily, politically, economically, any way you can think of. I would agree with Marvin Ott that the United States has no discernable policy for Southeast Asia beyond counterterrorism.

I'd be pleased to take any questions. Thank you.
[The statement follows:]

**Prepared Statement of Bronson E. Percival
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***China's Influence in Southeast Asia:
Implications for the United States***

Thank you for inviting me to appear before the Commission to discuss China's growing influence in Southeast Asia and its impact on U.S. interests in that region. This written presentation reflects my views, not those of my employer, the CNA Corporation. My views are shaped by my experience with the U.S. Department of State and as a Professor at the Naval War College working on Southeast Asia. I am now researching and writing a book on China's strategy and influence in that region, the reactions of Southeast Asians and their governments, and the implications for the United States of a changing dynamic among the United States, China, Japan and India in Southeast Asia.

Introduction

In Southeast Asia, China has sought to stabilize its southern periphery, minimize the possibility that another state could rally an anti-Chinese coalition, and gradually isolate Taiwan, while it both taps Southeast Asian funds and resources to contribute to China's economic modernization and portrays itself as an engine of growth for Southeast Asian economies.

In most Southeast Asian eyes, China has transformed itself from the state most often feared into, for most but not all, a perceived partner. This feat has been accomplished primarily through attentive and accommodating Chinese diplomatic leadership, from the top down, over the past decade. Chinese leaders have reassured Southeast Asian elites of their support for the political and territorial status quo. In addition, a booming trade relationship, which may shortly surpass that between Southeast Asia and the United States, and expectations that China's economic growth will also continue to contribute to their own prosperity, have moderated resentment over competition for foreign direct investment and export markets in developed countries. This does not mean Southeast Asian leaders are no longer wary of China, but it does mean that they are prepared to accommodate a larger role for China as one among several external powers with influence in their region.

China's emergence as a global economic power with increased economic, diplomatic and cultural influence in Southeast Asia does not signal the beginning of zero-sum competition between the United States and China in the region. Indeed, China's "rise" in Southeast Asia has had a more significant impact on Tokyo's status

and influence, as the Japanese economy sputtered over the past decade, than Washington's. Moreover, tensions in the U.S.-Chinese relationship—over intellectual property rights, currency revaluation, trade, and Taiwan—have not directly “spilled over” into the region. This is, in part, because both China and America share an interest in a prosperous and stable Southeast Asia, because more specific Chinese and American goals and interests are seldom in direct conflict, and because Beijing and Washington bring different strengths and weaknesses to their relations with Southeast Asian states. Even more important is the fact that Southeast Asian states do not want to become caught in either an external power's embrace or in strategic competition between larger states.

China's ultimate intentions towards the region are now unfathomable. In the past decade, Chinese influence has gradually increased as Beijing has moderated its demands and sought to woo Southeast Asian states and publics. Nonetheless, economic competition, China's energy requirements, and increased tensions between China and the United States could eventually sour several of China's current courtships in Southeast Asia.

The Setting

In debates over the implications for the United States of China's growing influence, the tendency to treat the Southeast Asian region as one state or economy distorts reality. Southeast Asia is neither a state, nor a nation, nor an economy. Instead, it is among the world's most ethnically, politically and economically diverse regions, and divided into eleven independent states. Ten of these states belong to the Association of Southeast Asian Nations (ASEAN), a regional organization. Unlike the European Union, ASEAN is designed primarily to reinforce individual state's sovereignty and territorial integrity. These sovereign states range from small, poor Laos, which shares a border with China, to Indonesia, a predominantly Muslim democracy nearly the size of the United States. Beijing's “charm offensive” and the economic pull of the Chinese economy have naturally had different impacts in different Southeast Asian states.

Most states in Southeast Asia do not believe they are faced with the choice of aligning with either the United States or China. Instead, most are able to engage with China and its booming economy on the one hand and, on the other, encourage other external powers to remain deeply involved. Moreover, Southeast Asian elites have often been adept in picking and choosing among the various components of Chinese, American and Japanese influence, and responding to different external powers' specific strengths. Thailand, for example, “bends with the wind.” Thais consider China their “best friend” and refuse to consider China a “threat,” yet are pleased to maintain the old U.S.-Thai alliance relationship and to recently be designated a “non-NATO ally” of the United States. The predominantly ethnic-Chinese city state of Singapore serves as a gateway for much of Southeast Asia's trade and investment in China and as a logistics hub for the U.S. armed forces. Even the Philippines, a U.S. treaty ally that has seen a massive increase in U.S. assistance in the connection with the war on terror, has reached agreement with China to jointly explore for oil in contested areas of the South China Sea and entered into a “strategic dialogue” with China. Indonesia, on which Beijing has recently lavished attention and investments, isn't going to be pushed around by anyone.

Not all states in the region enjoy such flexibility. The repressive regime in Burma (Myanmar) is dependent on China, which has provided the junta with \$3 billion in military and economic assistance. Southeast Asian efforts to encourage internal reform, primarily by including Rangoon in ASEAN in 1997, have failed. China's opposition to external interference in “domestic affairs” and its role as an economic patron of the authoritarian regimes in Laos and Cambodia have also given Beijing a predominant voice in these countries. America's interest in promoting human rights is thus compromised, but the United States has few strategic or economic interests in these three isolated, desperately poor states. Vietnam presents a different situation. Acutely aware of China's looming presence and of its long history of resisting China, yet led by a Communist party that has cultivated close ties to Beijing since “normalization” in 1991, Hanoi questions the reliability of major external powers and places inordinate emphasis on ASEAN. Thus Vietnam will focus on the economic component of its relations with the United States to strengthen its capacity to resist Chinese pressures while avoiding offending Beijing.

The Smiling Dragon: China's Comprehensive Strategy

Over the past decade, Chinese leaders and officials have turned their approach to Southeast Asia on its head, replacing assertiveness with accommodating diplomacy in the search for common interests. This concerted campaign, now led by Premier Wen Jiabao, has not only assuaged Southeast Asian fears but also laid the

groundwork for those who argued that Southeast Asians must participate in and profit from China's economic growth, rather than engage in a probably hopeless attempt to protect their own markets.

China's began by normalizing relations with all countries of the region, though Chinese denunciations of the "China threat" as a groundless, Western-inspired illusion had little impact until Beijing proposed initiatives and adopted policies designed to address Southeast Asian concerns. In 1997, during the Asian Financial Crisis that gutted the Thai economy and ultimately led to the overthrow of Indonesia's authoritarian leader, Beijing stepped forth to help prevent a deeper crisis by not devaluing its currency and by offering loans to ASEAN states, in stark contrast with the perceived harsh conditions attached to IMF aid. This led, in turn, to the founding of the ASEAN +3, a mechanism (excluding the United States) to develop regional solutions to East Asian problems. China also gradually gained confidence in the ASEAN Regional Forum (ARF), a "security" discussion process that it joined in 1994. In 2003, Beijing signed a Joint Declaration on Strategic Partnership for Peace and Prosperity and ASEAN's Treaty of Amity and Cooperation (TAC). In December of 2005, Malaysia will host a summit to establish the "East Asian Community," in which the United States will not participate. In addition, China has signed "Strategic Partnership" agreements with most Southeast Asian states, and most Southeast Asian leaders, on assuming office, now travel first to Beijing. The United States has not sought to compete, dismissing most of this evolving network as "talk shops" and focusing on the Asian Pacific Economic Community (APEC) Summit, which brings a U.S. President to Southeast Asia once every three or four years.

As Beijing's diplomatic leadership reassured its southern neighbors, China turned increasingly to supplementing diplomacy with economic ties, most dramatically in terms of trade. In many ways, its economic success has been as impressive as its diplomatic campaign because China and Southeast Asia are natural economic competitors, both for foreign direct investment (FDI) and developed markets in Japan, Europe and the United States. Early on, Beijing's invited ethnic Chinese Southeast Asians to invest in China, and subsequently went out of its way to include non-ethnic Chinese companies, principally from Malaysia and Thailand. Moreover, rapid increases in Sino-Southeast Asian trade helped pull the region out of the Asian Financial Crisis. In part to address concerns about China's accession to the WTO, Beijing first floated the idea of a China-ASEAN Free Trade Area (CAFTA) in 2000. Agreement has been reached that the goal is to remove all tariffs by 2015, though negotiations have not been completed. According to the CAFTA experts report, this free trade area contains more than 1.7 billion people, with a combined GDP of \$2 trillion and trade of \$1.2 billion. In addition, China has agreed to "early harvest" measures, which are perceived in Southeast Asia to provide them with earlier and easier access to the Chinese market.

In 2003, both U.S.-ASEAN bilateral trade (\$130 billion), and Japanese-ASEAN bilateral trade (\$119 billion) exceeded Sino-ASEAN bilateral trade (\$78 billion). In 2004, Chinese officials claimed that Sino-ASEAN trade had reached \$100 billion, while U.S.-ASEAN trade had grown only marginally. Most experts believe Sino-ASEAN trade will surpass Southeast Asian-U.S. trade in late 2005 or 2006. But the evolving trade relationship holds as much potential for conflict as for cooperation. The wealthier countries—Singapore, Malaysia, and Thailand—hope to find niches in an evolving East Asian market, but many Southeast Asian elites worry that China's often more efficient, low-cost production will flood them with cheaper Chinese goods, and that they will gradually become primarily providers of raw materials for China's voracious manufacturers. Already Chinese exports have supplanted domestic businesses in providing many relatively cheap manufactured consumer goods and agricultural products. In addition, along China's porous land borders with Southeast Asia, private trade and migration is transforming parts of Laos and northern Burma, which is now colloquially often referred to as "Yunnan South." China's major effort to develop its own Southwest through improved transportation links into mainland Southeast Asia, a project in which Beijing has been particularly eager to encourage participation by major Thai and Malaysian companies, will open new trade opportunities.

Moreover, Southeast Asians are already acutely aware that China is sucking up most of the FDI that used to flow to them. In 1990, ASEAN attracted twice as much of the foreign direct investment (FDI) into the "developing Asia-Pacific" as China; in 2003, it attracted one-third as much. Southeast Asian states have started to respond by improving their investment climates, though the results have clearly been mixed. In addition, Southeast Asian officials have been concerned about an imbalance in Southeast Asian investment in China and Chinese investment in Southeast Asia. In 2002, one source had Southeast Asian investment in China at \$58 billion, compared to \$1.4 billion. But investment figures are notoriously inaccurate, and ac-

tual current Southeast Asian investment may be as low as \$30 billion. Moreover, Southeast Asian companies have not always found their investments in China to be as profitable as expected, and are now more hardheaded. However, Beijing has begun to recognize the problem, both arguing that China's economic growth will lead to more investment in Southeast Asia in the future and promising to try to increase FDI now. And the Chinese appear to be following up on their promises, at least verbally. During Wen Jiabao's 2005 visit to Indonesia, he said that China expects to invest \$10–20 billion in Indonesia over the next few years.

Most of that investment is likely to be to develop Indonesia's natural, and primarily energy, resources. China is now seeking to acquire energy throughout much of the world, and Southeast Asia is no exception. China (and Taiwan) and four Southeast Asian countries claim parts of South China Sea, which are believed to contain substantial oil and gas resources, and Beijing appears to have made a strategic decision to focus on exploiting these resources, increasingly in cooperation with other claimants, rather than, for now, pressing its territorial claims. Although China selected Australia over Indonesia as the supplier for an approximately \$10 billion Liquefied Natural Gas (LNG) deal to supply China's first LNG terminal, Indonesia was compensated with smaller deals. Also, Beijing, in 2003, publicly committed to discuss possible future natural gas purchases with Indonesian leaders. Chinese companies have also recently acquired more than a billion dollar stake in Indonesian oil and gas fields. The current bid by the China National Offshore Oil Corporation (CNOOC) to acquire the California-based Unocal has become a political issue in the United States, though it has engendered little comment in Southeast Asia. As the press has reported, 70% of Unocal oil and gas reserves are in Asia, mostly under long-term contract to Asian nations like Thailand and Indonesia.

China has also started building dams for its own energy consumption on the Mekong River, which have had a negative impact downriver in Southeast Asia. China participates in a project supported by the Asian Development Bank to produce hydroelectric power by building dams on the Mekong, as well as improved transportation links. These dams have limited water flow downstream in Laos, Vietnam, and Cambodia, which had a particularly serious impact on Cambodia's food supply.

Within the next twenty years, it is estimated that two-thirds of China's petroleum imports, which will have quadrupled, will flow from the Middle East through Southeast Asian waters. About half of the world's oil and gas trade already flows through the Strait of Malacca, the world's most important maritime chokepoint. The United States Navy has dominated these waters since the end of the World War II. Proposals have been floated to construct oil and gas pipelines through Burma from the Indian Ocean to China and across the Kra peninsula between the Indian Ocean and the Gulf of Thailand.

As Beijing enmeshed itself in this new diplomatic and economic network, it narrowed its political goals. Topping a short list comes isolating Taiwan. It is difficult to distinguish the motivations behind Southeast Asian rebukes of Taiwanese President Chen for some of his statements and initiatives. The perception that Taiwan has become a greater risk to regional stability is probably a more important cause of this criticism than Beijing's increasingly firm pressures regarding Taiwan. But Chinese officials have blocked all visits by Taiwan's President to Southeast Asia and no head of state or government in Southeast Asia visited Taiwan in the new century. Moreover, Southeast Asian leaders and officials were increasingly reluctant to meet with their lower ranking Taiwanese counterparts. Beijing reacted sharply to an "unofficial" visit by Singapore's then deputy, but anointed, Prime Minister to Taiwan in 2004, before he assumed his new position. Singapore was believed to have subsequently cancelled a planned port visit by Taiwanese naval ships, while reportedly Malaysia assured Beijing that it would contemplate no such mistake. The last Southeast Asian Cabinet minister to visit Taiwan was apparently an obscure Indonesian Cabinet minister in the spring of 2005. Still Taiwan is not yet roadkill in Southeast Asia, where it retains significant investments. Moreover, the region's leaders would be deeply disturbed by Beijing's employment of force to resolve the Taiwan issue. However, the last thing any Southeast Asia country wants is to be dragged into a Chinese-U.S. military confrontation over Taiwan.

Security

The term "security" does not always have the same meaning for Southeast Asians and Americans. Southeast Asian leaders often stress the economic and "soft power" components of "resilience" or "comprehensive security" as much as pure military power. Beijing's 1997 "new security concept," which rejects "hegemony," resonates well in Southeast Asia. It also helps China indirectly devalue the relevance of America's role as the ultimate "security guarantor" in the region.

As diplomatic and trade ties have led Chinese efforts to knit itself together with Southeast Asia, Beijing has wisely allowed security relations to follow at a pace that individual Southeast Asian countries find comfortable. Even to reach this stage, Beijing had to at least temporarily set aside confrontation associated with its claims in the South China Sea, which conflict with those of several Southeast Asian states (and Taiwan). Clashes in these waters, which may include substantial energy resources, with the Philippines over Mischief Reef in 1995, were followed by more moderate reaction to a series of subsequent incidents. Finally, in 2002, ASEAN and China negotiated a code of conduct for the South China Sea, and in March 2005 Beijing further reduced tension by proposing joint technical work on oil resources in some areas of the Spratly Islands also claimed by Manila and Hanoi. China has also negotiated land border disputes with Laos and Vietnam, as well as the maritime dispute with Vietnam in the Gulf of Tonkin. Although some in Hanoi reportedly feel China got more than was fair, the overall message to the region was Chinese willingness to negotiate and compromise, rather than throw its weight around.

China has also been prepared to provide military equipment to some Southeast Asian countries. The close security relationship between Burma and China has been solidified with about \$1.6 billion in Chinese military assistance, and China is rumored to maintain some sort of listening post for the Indian Ocean on Burmese territory. China has also been prepared to sell military equipment to other Southeast Asian states, but most don't appear to be very interested, and China's large sales to Thailand in the 1970s have not been replicated elsewhere. In 2004, Malaysia acquired some missiles from China.

China has occasionally also tried to chip away at American security dominance, though it has toned down its criticism of the U.S. military presence in the region since 2001, when U.S.-China relations began to improve. During the negotiations that culminated in the Code of Conduct, Chinese officials tried to use the discussion to raise the possibility of restrictions on U.S. naval exercises in the area. China also hosted a 2004 Security Policy Conference with the ASEAN Regional Forum (ARF), in part as an alternative to an annual U.S.-backed high-level security forum, inaugurated in Singapore in 2002. On the other hand, Beijing's stance on U.S. military forces conducting counterterrorism training in the southern Philippines and to high-profile U.S. efforts to improve security in the Strait of Malacca, the world's most important maritime chokepoint, has been low-key and moderate.

Finally, China and ASEAN have agreed to work together to combat non-traditional security threats, such as transnational crime, terrorism, piracy and drug trafficking, on which further progress is expected this year.

The bottom line is that China has little ability to project military power beyond its land borders, and faces overwhelming U.S. naval dominance in the waters between China and Southeast Asia through which European colonial powers attacked China in the 19th century. ASEAN states have given little thought to the possible implications of China's military modernization, though they have urged greater transparency and encouraged military exchanges and discussions in ARF and other organizations. China has every reason to downplay security in its relations with Southeast Asian states, and to portray China's rise as an economic rather than a security challenge.

The Ambivalent Giant: The United States in Southeast Asia

Those who question China's influence in Southeast Asia point to the fact that China has, in fact, asked little of Southeast Asians. They also question the relevance of image, perceptions and other elements often grouped, with economics, under the label "soft power." Given the fuzziness of this term, it is tempting to agree with Secretary of Defense Rumsfeld, who is alleged to have claimed that he didn't know what "soft power" meant. But an attempt to dismiss China's economic/diplomatic influence by pointing to America's continued military dominance in Southeast Asia does little to meet Southeast Asian pleas for reassurance that Washington understands their priorities of domestic economic development and political stability. One journalist, perhaps exaggerating, called the difference in perceptions "one earth, separate planets."

The United States is entrenched in Southeast Asia. The dominant military force in the region, it competes with Japan as the economic power, in terms of trade, investment and aid. China may move to the top as a trade partner, but both cumulative Japanese and American investment and both countries' annual aid far outstrips China's. Despite diminished credibility in the past four years, America retains a political and cultural appeal among many Southeast Asians, from human rights activists to nationalistic military officers. Washington has also devoted more high-level attention to Southeast Asia, albeit exclusively in the context of counterterrorism, than it has for over thirty years, since the American withdrawal from Vietnam.

At one point Washington labeled Southeast Asia the “second front” in the Global War On Terror (GWOT). It has intelligently designed a plan to combat terrorism in the region, based on cooperation with and assistance to relevant Southeast Asian states. This campaign has worked well, though many Southeast Asian Muslims remain dubious about American intentions. These doubts are primarily a consequence of the U.S.-led invasions of Afghanistan and Iraq, and the continued insurgency in the latter. Muslim majority democracies, such as Indonesia and Malaysia, have had to balance popular antipathy to the current U.S. Administration with their desire to cooperate against the regional terrorist network aligned with al Qaeda.

Although Washington has appropriately focused on countering terrorism, the “rise of China” may eventually prove to be a second challenge for the United States in the region. Washington’s current response has been ambivalent and ambiguous. Southeast Asia tends to be treated as a footnote to larger issues in the U.S.-Chinese relationship. Most experts agree that an American attempt to portray Southeast Asia as a battleground in a zero-sum contest with China is misleading and could turn into a self-fulfilling prophecy. But the United States has so long seen itself as the unchallenged, benign superpower in the region, that there is a whiff of complacency in the air.

In any case, both Tokyo and Washington have been slow to react to China’s “rise.” Beyond combating terrorism, American policy is disjointed, as demonstrated by the fact that seven Southeast Asian states remain either under or threatened with U.S. sanctions. Southeast Asians are often both impressed with America’s support for “reforms” and annoyed with the way Washington presents its demands.

Washington’s response to China’s growing economic influence has consisted of the anemic Enterprise for ASEAN Initiative announced in 2003 and negotiations on three free trade agreements exclusively with the richer members of ASEAN, that is Singapore, Thailand and Malaysia, two of which have been concluded. But perhaps the most striking trend involves image. Some of this is Southeast Asian infatuation with the “new” China, and it will wear off. However, America’s reputation and credibility is at its lowest level in the region in thirty years. For example, polls taken in Thailand in 2003 showed seventy-six percent of respondents considered China their best friend, while nine percent picked the United States. The polling is similar, if less dramatic, elsewhere in the region. The American outpouring of assistance, both public and private, in the wake of the Indian Ocean tsunami, dwarfed China’s contribution. It is much appreciated, but one demonstration of the impressive capacity of the U.S. Navy and of the generosity of the American people hasn’t overcome years of perceived neglect.

Recommendations for U.S. Policy

The United States should not overreact to China’s re-emergence as one of several major economic and diplomatic powers in the region. Southeast Asians, moreover, will resist attempts to include their region in any Chinese-U.S. strategic competition that may be based on issues elsewhere. However, the United States could more effectively employ its extensive political, economic and security assets in the region if it paid more attention, identified U.S. priorities beyond countering terrorism, and focused on non-traditional security issues that are important for both America and Southeast Asia.

(1) Establish Priorities

After 9/11, Washington designed a cost-effective, largely successful counterterrorism policy for the region, though it never seemed to dawn on American policymakers that U.S. actions in other parts of the Muslim world would undercut America’s image and influence in much of Southeast Asia. Beyond that, the long list of stated American interests includes promoting human rights and democracy, maintaining regional peace and stability, maintaining a U.S. presence and close relations with allies, maintaining freedom of navigation, maintaining trade and investment relations, and so forth. The strength and balance of America’s entrenched position in much of Southeast Asia has permitted individual constituencies to push their own agendas, with priorities usually sorted out in an ad hoc fashion based on their impact on individual bilateral relationships. The result is that the United States often appears to lack a regional policy. Some experts argue that more emphasis should be placed on the premier regional organization, but ASEAN lacks the capacity to serve as a partner in implementing policies that cut across national boundaries. The U.S. needs to design a regional strategy.

(2) Pay More Attention

Responsible for the national security of a global superpower now bogged down in Iraq, Washington’s policymakers apparently see little beyond North Korea and China when their gaze occasionally turns eastward. The assumption seems to be

that the United States can rely on allies and friends to protect its interest in Southeast Asia, which are unlikely to suffer more than gradual erosion in the short term. But Australia, Japan and India, not to mention America's friends and allies in Southeast Asia, have their own limitations and their own interests. Moreover, Southeast Asia requires a hands-on approach. Secretary of State Rice's decision this month to substitute a 6-hour visit to Thailand for the annual ASEAN/ARF meeting that U.S. Secretaries of State have attended for the past twenty years was counter-productive, as many regional leaders publicly noted. Deputy Secretary Zoellick appears prepared to become "Mr. Southeast Asia" for the Administration, but if he becomes distracted the most senior U.S. official that Southeast Asian leaders see regularly will become the commander of U.S. forces in the Pacific. No matter how talented, no military officer should be asked to shoulder the burden of advancing American trade, investment or aid interests.

The blasé American response to the evolving network of East Asian regional organizations, from which the United States is now often excluded, could also eventually prove costly. If economic trends gradually tilt the playing field against American firms, the refusal to "play the game" could eventually leave America attempting to influence important decisions from the margins.

(3) *Focus on Non-traditional Issues*

The massive American response to the Indian Ocean tsunami reminded Southeast Asians of America's ability to help them. If the United States focused on non-traditional issues that cut across national boundaries, it could help itself by helping others. For example, anti-terrorism could be expanded to include maritime security and the United States has a wealth of talent to devote to combating potential epidemics such as avian flu. Finally, many Southeast Asians are now flocking to Chinese universities. Americans have an interest in ensuring that Harvard and Berkeley remain the destination of choice for Southeast Asia's best and brightest.

Panel VII: Discussion, Questions and Answers

Cochair TEUFEL DREYER. Thank you very much. We appreciate this. I have Commissioners Donnelly, Wessel, Becker, D'Amato and Mulloy asking questions. Have I missed anybody? Commissioner Donnelly.

Commissioner DONNELLY. Thank you, Madam Chairwoman. One quick question and then a broad question for the panel. I would ask all of the panelists to comment on the political implications of the Unocal sale in Southeast Asia. Dr. Percival addressed it a little bit. I'm struck by the fact that not only is more than two-thirds of Unocal's holdings there, but the fields in Indonesia and the gas plant in Indonesia are essential facilities for Japan, Taiwan and South Korea. So, again, the regional political impact of that?

I'm also kind of on the other end of the scale struck by the divergence of opinion about American strategy in the region. Although there is kind of a weird confluence in the sense that people generally agree that there isn't much of one. On the other hand, the macro result seems to be that our position in the region is still okay. I would like you guys to try to connect those two seemingly contradictory dots, if that is possible.

Mr. BLUMENTHAL. Okay. The political strategic implications of the Unocal deal I think has to be seen in the context of, you know, Chinese trying to mitigate what they feel is their vulnerability in energy security and energy in general, and I think you see a general strategy—you heard a lot about this yesterday, I'm sure, but you know that is paying, for example, premiums to try to control energy at the source, not confident that the market that is going to work, not trusting of the United States to provide security, looking for ways to avoid disruptions. I think that's what they're most focused on. So if they can buy even at premiums, equity stakes at the source, they feel like they can mitigate their energy risks.

But, of course, this is not a strategy that makes a lot of sense from the point of view that energy and oil is fungible, but that's reflective, I think, of Chinese suspicions and intentions. If they intend to cause trouble in the region and think that the United States will react by shutting off the spigot or blockading them in the sea-lanes, then, of course, they need alternatives. So it's reflective of a deep suspicion and aspirations as I mentioned before that they feel the U.S. will react to.

The question of the U.S. position and the U.S. strategy, I take a different view. I think that north Asia, in general, north and east and Southeast Asia in general, I think, there is this kind of containment by any other name going on, and no one wants to talk about it. The U.S. goes out of its way to say this is not about China, but look, the first prime minister of Vietnam came to town recently. The Indian prime minister came to town recently. The Australia relationship is upgraded. The Japanese defense relationship is upgraded. The Singapore relationship is upgraded.

To China, if I were sitting in China, I would think, you know, I was being contained. It's true that the United States hasn't engaged in other dimensions, and I think the democracy dimension is incredibly important in terms of Southeast Asian and Northeast Asian national aspirations and I would refer you to the latest Journal of Democracy, which published a study on just how popular the notion of consolidation of democracy is in Southeast Asia. And on that issue, of course, China cannot compete with the United States.

Dr. CHINWORTH. My own views might be a little bit contrarian. I wasn't terribly upset about the Unocal sale one way or another. It's a global market. I've seen other countries like Japan try to assure independent supply of energy sources and it just didn't work. You need buyers and sellers. And you play out the worst-case scenario of that acquisition by China. The worst-case scenario is that energy prices spike so high that China is actually forced to put those supplies on the international market because they can make huge profits. And so the market would rectify itself.

So I'm not necessarily concerned about. The concern I would have, though, is if Marvin's portrayal of China is correct, then China has just suffered another indignity at the hands of the West, specifically the United States, and has something else to be mad about and something else to make up for.

I'm neutral on that. And since I'm plagiarizing Marvin, I'll let him speak for himself.

Commissioner DONNELLY. I just want to make certain my question is clear. I'm interested in the specific political impacts in the region, in Indonesia even, of this transaction.

Dr. CHINWORTH. Well, then I would point to that then, the potential—if again Marvin's portrayal is correct, then the potential of heightening those feelings of frustration. That would be my concern. For U.S. policy in the region, there is one element that we have been consistent on, and that is the U.S.-Japan security relationship, and I feel comfortable with that.

The U.S. isn't going to back off of that. I don't see any signs that Japan will back off of its commitment to the bilateral security relationship, but again our activities in the region could be expanded. The U.S. military does a great deal in humanitarian relief, humani-

tarian efforts across the region. I'd like to see more, and again if the U.S. is an obstacle to China in achieving broader regional goals, if we are getting in the way, then I'd say getting in the way sounds like a very good policy to me.

Dr. OTT. Very quickly, it strikes me the commentary on Unocal in New York and in this town is that, well, Unocal reserves are in Southeast Asia, a long ways away. The U.S. doesn't get its oil from Southeast Asia. We get it from elsewhere, West Africa, Latin America and so on. So this really isn't an issue in terms of U.S. energy security. Everything is fungible. So everybody relax.

It may be that we can relax, but as a non-economist, or certainly not an oil economist, looking at this strategically, what strikes me is that it's precisely because those reserves are in Southeast Asia (gas and oil) that it makes all kind of sense for China to make a bid for Unocal.

To Commissioner Donnelly's question, it will not go unnoticed in the region that China—assuming China were successful with regard to Unocal—that China now has become the owner of major gas and oil reserves in the region. It will become yet another step in a comprehensive strategy, beautifully conceived and implemented, to establish Chinese presence and influence. It would be fully consistent with the overall pattern.

With regard to overall policy, is the U.S. position in tatters in Southeast Asia? No, it's not. But in my judgment, we're running on momentum. We have built up an overwhelmingly influential and strengthened position over decades in the region. It is now being chipped away. It is not as strong now as it was ten years ago. And my concern is not that our position is about to collapse. It's not. My concern is I want to think strategically about this.

We face a challenge. We need to understand what we're up against and we need to start thinking ahead and, I'd like to try to get away from the usual thing in this town. I recall a conversation when I was on the Hill at one point talking to the then Staff Director of the Senate Foreign Relations Committee. We were talking about something, and he said, look, if you're talking about something more than two weeks out, forget it. He says I don't operate beyond that. Well, I'd like to operate beyond two weeks. I'd like to think ahead.

Commissioner DONNELLY. Maybe three. Three weeks.

Mr. PERCIVAL. Let me just talk for a second. I did try to find what kind of public reaction there had been in Southeast Asia to the Unocal bid by the Chinese oil company. There had been very little, but obviously it's not something that's gone unnoticed. China has also been buying just as quickly as they possibly can into Indonesian oil and natural gas resources although they did pick Australia over Indonesia for a very large LNG project.

If the Chinese company acquired Unocal assets in Southeast Asia, it's not that it would affect the Chinese market because most of that is already set to come ashore in Thailand or Vietnam or whatever it may be, and these are long-term contracts. But obviously, it would seem to me to have strategic implications.

On the question of U.S. power versus U.S. strategy, one of the things that bothers me in looking at our policy in Southeast Asia, and I think Dr. Ott is absolutely right, we've built up such an over-

whelming position that there's a certain whiff of complacency on the part of the United States.

We have done, I think, an excellent job in putting together a regional counterterrorism strategy. But beyond that, there's a tendency to react to whatever the domestic issue is at that particular time, and we're not competing with the Chinese in a comprehensive way and that's particularly true in terms of this evolving network of Asian diplomatic institutions, organizations.

Cochair TEUFEL DREYER. Okay. Good. Next is Commissioner Wessel.

Cochair WESSEL. Thank you all for being here. I'd like to use Mr. Blumenthal's comments from his recent article "Unhelpful China," if I could, just as a springboard if I could, that you indicate that U.S. policymakers I guess need to recognize that traditional engagement policy with China doesn't appear to be working.

Others talked here about not really having a policy, and we've seen China engage in Sudan and assist in the providing weaponry that potentially is being used in the genocide there. Iran, they've transferred missile technology. North Korea, we're still doing a slow dance on the question of their nuclear weaponry and capabilities there.

Taiwan, they continue to build up forces for coercive or potential actual use in the Straits. IPR, we just signed, I believe it's our fifth deal to get them to promise to deal with piracy that is in 90 percent plus ranges, and two years from now when we find out that nothing has happened, we'll probably sign our sixth deal to get them to do so.

I think that engagement has some real questions. But what do we do? What should our policy be looking beyond two weeks? Should we just say that this is China's sphere of influence and have a multi-polar/multilateral, whatever the correct interpretation is, based on our last panel, and share the world or do we have some real interest there that need to be protected and that we should be more active in pursuit of what our policy goals should be?

Mr. BLUMENTHAL. Thank you, first, for reminding me of the contents of the article. I was afraid for a second. It was nine months or something. Even if we wanted to, it always strikes me when I talk with traditional Sinologists, that they have a decent understanding of China but a little understanding of the United States. We're not going to cede ground to China. It's been our policy and strategy for a century at least not to do that, and certainly since the Cold War. And certainly we believe, and I think most Asians would agree, that our presence has contributed to the prosperity and democratization of many countries including China, not democratization but prosperity.

So what do we do? Well, containment is a loaded term because it has the Soviet baggage to it and of course China is not the Soviet Union. Its ideology is not attractive to people and that sort of thing, but I think I would agree with Marvin Ott, there is a great game, it's a very competitive relationship, and I think that we are indeed embarked upon a containment policy.

I think there is danger in not calling it that, at least in terms of Chinese military power. I think we're finding ready partners in

the region who again don't want to call it that, but Japan I think is inching a little bit more towards calling it that. Again, India, Vietnam, Australia, Singapore.

There are dangers in doing what we're doing, and trying to convince people that we're not doing it I think. I think we have to be very firm first on the fact with China that we're not going anywhere, and this is what you get. You get contained if you continue along the path of military aggrandizement. You get surrounded by countering coalitions.

I think in terms of the other parts of a strategy is there should not—there ought not be a China exception to the promotion of democracy that the Bush Administration is assertively pushing, but of course has been a part of U.S. strategy for years and years and years.

It's not farfetched. I would say that probably the number one issue among the ordinary Chinese person is the corruption issue. And also, there are a tremendous number of losers in the society. I don't mean that these people are losers in the derogatory sense but have lost in the social transformation without proper avenues of voicing their grievances.

There were 58,000 protests in the last year. Some of them very violent. So it's not a farfetched notion. And I think the only way to come to some kind of accommodation in the future with China over Asia is indeed to push hard on the democracy front.

Cochair WESSEL. Thank you.

Dr. CHINWORTH. I'd endorse that. I'd also add that I'd like us to look internally as well. In my statement, I mentioned that in Japan's case in particular, there are a number of economic policies that it needs to pursue before it can even consider China's impact on its own competitiveness.

Tokyo has fallen relative to Beijing in the region. There's no doubt about it. But in my view, much of that decline has been self-inflicted. I'm sure some of my Japanese colleagues would say, Uncle Sam, look in the mirror when I make that kind of a comment as well. So we do have a number of policies here that I'm sure could be addressed that do affect our ability to influence the region.

One small indicator—the decline in foreign students applying to universities in the United States. I view this negatively for a couple of reasons. First, because we're losing out on some good brainpower in American universities. But secondly, it means that other countries in the region think there's a better deal elsewhere.

We need to make this country a good deal to other countries in the region. We need to make it attractive. We need to maintain our level of investment in research. We need to maintain our openness. We need to maintain our mechanisms for developing networks with other nations in the region.

So I'd say yes, there's a number of things we can do internationally, but look at home as well, especially again because I'm focusing on U.S.-Japan and there are number of policies in both countries that would strengthen that relationship which benefits the region and also strengthens both nations in the global environment, the global economy, and makes both countries look like a more attractive promise than China for the future of these nations.

Cochair WESSEL. Out of courtesy to my fellow Commissioners, if the other two panelists can provide the answers to that afterwards so that others have an opportunity. I'd be interested though in your comments.

Cochair TEUFEL DREYER. Thank you, Commissioner Wessel. That is deeply appreciated by the rest of your fellow Commissioners who have questions. Commissioner Becker.

Commissioner BECKER. Thank you, Madam Chairman. Let me take just one second here to tell you how much I really appreciate your contributions in several different directions. I have two questions. And if history bears me out, I won't have time get the second one in. My questions usually take too long.

Let me first concentrate on a word that was used by several of the panelists right at the beginning, "comparative advantage," and we're talking about this miracle of growth in China. Do we really consider where it came from; what is the comparative advantage that China offers? Repressed labor, restricted human rights, controls, absolute controls on the people. What do you think attracted industry from the United States, the multinationals headquartered in the United States, to locate over there? Cheap wages? They have no benefits, no health care, so we talk about competition, we talk about competing, and I think we drift away from that of what we're really talking about, and my question goes on this:

If China is going to be the example that we're going to hold up to the world in globalization, are we telling the other countries if they want to compete like China, they should do like China? That they should push democracy in the back, background? And that's my question there.

Let me get my question out to Dr. Ott because you really hit, you eliminated most of my questions because I agreed with what you were talking about, the—and I'm concerned about the strategic interests of the United States. We never talk about the strategic interests of the United States in South China.

I want us to do that. I think we've got of advocated or at least I've been told by other experts that we've abdicated our position of leadership within these countries that rings the South China Sea. And I would like to have some thoughts on that. I don't care which one goes first. Go ahead.

Dr. OTT. Let me just continue on down the line here for a second. There was a lot in that, and I'm going to cherry pick a little bit I guess, but I'd like to use it pick up on Commissioner Wessel's earlier point about engagement.

I've used the term "geopolitical" and "realpolitik" a few times. These are old-fashioned terms. They're very much out of common parlance today. The common parlance today is much more in line with what Dan said earlier about a democracy agenda vis-à-vis China. My quick comment is that what that implies is that we are in effect establishing ourselves as a mortal threat to the Chinese government. That we stand for, quote-unquote, "peaceful evolution," which the Chinese rightly view as overthrow and destruction of the Chinese government as happened in the Soviet Union, as happened in Eastern Europe. That's the way the Americans do it. That's what they plan to do to us and if that's the way the rela-

tionship gets defined, we now have a strategic face-off, which is truly zero sum.

From a realpolitik standpoint, that's not the way you want—
[Recess.]

Cochair TEUFEL DREYER. Chairman D'Amato, the floor is yours.

Chairman D'AMATO. Thank you, Madam Chairman. This is a question for Mr. Bismarck, Mr. Ott and also Mr. Blumenthal. I want to compliment you on the very succinct and accurate way that you've portrayed Chinese approach to the world, which is I believe realpolitik. In terms of the energy patch, it's very clear it's mercantilist. It's acquisition oriented. I don't think the Chinese for a moment buy anything to do with the concept of globalization except when it benefits them.

So we're operating on two different concepts. I think it's very difficult here for the United States to understand that we're working on the basis of a concept of globalization, which is promoted primarily by the multinationals. The Chinese are not working on that basis whatsoever. They'll take what they can from it, but they're not going to give anything to it in the way that we would expect them to. I think that is a problem.

So the result is American policy in the region if we're to be effective, one policy, I guess, is what someone calls democratic strategy. I don't know how you do that unless you air drop 500 million copies of the American Constitution.

There is not going to be any democracy strategy in cooperation with the Chinese government. So I guess the last alternative for the United States is to work on basically our interests in the region, make sure they're protected and work with the Chinese at every stage where we can, but make sure that our interests are protected. In that respect I want to ask the panel, Dr. Ott and anybody else who thinks they can contribute on this, what actually is happening with the Japanese relationship?

We have a new generation in Japan. We've been reading about new Japanese nationalism of some kind. But as the Japanese are not fools, they can see that the Chinese are acting as mercantilists in the region, what is the natural Japanese reaction? What do we expect the Japanese how to react to the situation and can it be in the context of an overall U.S.-Japanese alliance in the region. Dr. Ott?

Dr. OTT. Real quick and then I think Dr. Chinworth should weigh in on this one. It used to be that when you talked about Japan, anything political, strategic, military, alliance related, the first comment was nothing happens in Tokyo. Basically the Japanese can't make a decision on anything because the prime minister has no power, the whole system operates by consensus. You've got all these entrenched interests, very conservative. It takes forever for initiative, any kind of change, for example, in the alliance relationship to be implemented.

That has changed. It is really extraordinary and striking to watch against that backdrop what's happened in Tokyo over the last three to four years. Under Prime Minister Koizumi, you've now had a substantial strengthening and closing of the U.S. alliance relationship. You've got Japanese ships in the Indian Ocean. You've got Japanese boots on the ground in Iraq. You've got a whole series

of initiatives like this, which would have been virtually unthinkable four or five years ago, it seems to me.

Why? Reduce it to a sentence—the Japanese are looking at China and they are becoming acutely aware that this huge country that they have poured overseas development aid into and have tried to benignly win over and turn into a kind of well-healed ward of Japan has, in fact, become threatening, potentially threatening, increasingly powerful, adversarial in its political relationship. There is a lot of acrimony now, a lot of criticism whether it's the visits to the Yasukuni shrine, whether it is apologies for World War II, whether it is Chinese submarines going to the EEZ of Japan. A whole series of issues have turned the Japan-China relationship in a very different direction.

The Japanese have responded, have in effect seen the balance of power in Asia shifting against them in a very dramatic way. They have become very much aware of that. North Korea is part of that picture and they have responded in the only way they can see they can respond by tightening the relationship with the United States.

So this is a very rapidly evolving situation against the backdrop of what has been traditional in Japan.

Chairman D'AMATO. Thank you.

Dr. CHINWORTH. Absolutely no argument with that at all. And that's again, my point is we need to strengthen that relationship further. I think Japanese, and especially the older business generation, are asking themselves whether they have reached the point now where they need to make a choice, where they're going to be forced to make a choice between the economic prosperity—or dependency—that China offers to Japan, and the larger relationship with the United States, and my answer obviously is we need to do everything possible to make sure that choice is always with the United States first and foremost. So I wouldn't argue at all with what Marvin mentioned.

I think there's a number of steps we can take to strengthen that relationship. I think the Japanese government is inclined to look for new ways to extend its influence positively in the region, through its military and economic activities. We need to support that and do everything possible to make sure that that relationship remains the starting point for Japan and not the finishing point.

Chairman D'AMATO. It seems to me we should be grateful that the Japanese would be looking to strengthen the U.S. relationship rather than going on their own, which would cause another problem of a different dimension.

Mr. Blumenthal, did you have any—

Mr. BLUMENTHAL. Yes. Just on the much maligned democracy strategy. I think if we were perfectly honest, we would say that the assumption behind the engagement strategy is to transform China into democracy. And so the problem there is that, of course, China has to, as Marvin Ott pointed out, has to agree to that.

And they're not. So we already have a democracy strategy or at least the assumption behind it is a democracy strategy. We're just not implementing it very well. Of course in an engagement strategy, the Chinese government has to agree with us that they're going to be engaged in a way that will transform them which is a leap of logic for them.

So, just to be all the cards on the table, that is what we've been trying to do for the last 15 years, and I don't think a democracy strategy is that farfetched. There are a lot of NGOs, and just to take one example, inside China. They can't communicate with each other. There's 2,000 of them or something like that—the last thing I read. They're not allowed to communicate with each other. Well, there are all kinds of rhetorical tools that we have. There are all kinds of other groups in China that we can work with and I don't mean forceful regime change, but we see democratic revolutions all around us, and I don't think it's as farfetched as people might think.

Cochair TEUFEL DREYER. Mr. Becker was not quite done, but he isn't here. Okay. Commissioner Mulloy, we have five more minutes and so if you would direct your question to a specific speaker, please?

Commissioner MULLOY. Dr. Dreyer, I would like to yield my five minutes now to Vice Chairman Robinson who has a question, and then he'll yield his time back to me.

Cochair TEUFEL DREYER. Gold.

Vice Chairman ROBINSON. Thank you, Commissioner Mulloy and Madam Chairman. I just wanted to follow up on Chairman D'Amato's point for just a moment because I'm very impressed with the change in the atmospherics in Sino-Japanese relations, and I've spent a lot of—well, a fair amount of time there recently, and have taken note of the fact that this is a really quite breathtaking set of developments.

So it seems there's concurrence among the panelists that Japan has woken up and smelled the coffee on the Chinese threat now and down the road. The questions I have are the deterioration in Sino-Japanese relations don't appear to have an identifiable end in sight for security-related economic and historical/cultural reasons. I was wondering, one, if that strikes you as right or am I being too pessimistic there because I just don't see the stop in the system so to speak?

The second has to do with Japan realizing or giving material expression to its new appreciation of the Chinese threat by increasingly breaking out of its constitutional and other self-imposed restraints such as accepting a fully or even embracing a fully interoperable Aegis-based missile defense arrangement with the United States, strengthened or the procuring of aerial refueling capability and other power projection capabilities, possibly purchases of new 767 AWACS, a new generation fighter to meet the SU30 challenge, and even enhanced maritime patrol with its own indigenously manufactured air time, maritime and surveillance aircraft, going to the point where it could even be the procurement of Tomahawk cruise missiles under the banner of preemptive defense.

Do you see these kinds of trends in these actual procurement terms and others?

Dr. OTT. Can I give—sorry.

Vice Chairman ROBINSON. Yes, Dr. Ott, and if we have time I'd love to hear from—

Dr. OTT. Two sentences. On the "brake," I think the brake exists in the extremely deep economic relationship that exists. Also, if Prime Minister Koizumi's in effect term is up not too long from

now, you can imagine him being replaced by a LDP successor who adopts a little less provocative posturing on Yasukuni and things like that. And so some of that neuralgia gets reduced.

So I think there is a brake frankly and on the other side of it, how the U.S., Japan military to military relationship grows, I think everything you identified is entrain.

Vice Chairman ROBINSON. Yes, Dan.

Mr. BLUMENTHAL. On the specific weapons systems, I think what we're still looking, and Mr. Chinworth would obviously know a lot about this as well. I think we're still looking at a rather cautious Japan. They've said things that are obviously not so cautious rhetorically in terms of the common strategic objectives and so forth, and have certainly signed up to BMD both in terms of SM3 and PAC3s and now the devil is in the details in terms of working out the interoperability and the command arrangements, and I think that's going to be much more difficult work.

I think Tomahawks and things that have an offensive flair to them, not that I would argue are offensive, are probably a bridge too far for the Japanese defense community right now. As far as I read their military concerns, I think you're going to see a lot of BMD, a lot of C4ISR and a lot of naval surveillance of all kinds, including undersea surveillance. If the United States and Japan and maybe even Taiwan can ever get together to form that again.

So I think that's going to be where their focus is, and I don't know if you have—

Dr. CHINWORTH. I wouldn't disagree with anything. I would modify the assumption in your first statement, China as a threat to Japan. What makes it so difficult for Japan is that they don't know if they're dealing with a threat or the land of economic opportunity. That's the real problem.

It's this complexity that's driving Japan crazy. We recognize that this is not the old Soviet Union. This is a much more sophisticated situation that has promise and some potential problems as well. The animosity between the two countries is one factor that I think extends across the region with regard to China and it's going to limit its capabilities to achieve its objectives.

I wouldn't encourage continuing that animosity but I think it's going to be around for a while. It is manageable. It seems to flare up whenever China wants to score some diplomatic points against Japan.

On the military fronts, many of the items you mentioned are moving forward. I think more can be done. Personally I don't think we need to mention the constitutional restraints because everything that's been achieved to date has been achieved under its peaceful constitution, and talking about constitutional revision is a distraction that takes us away from really focusing on the more important questions of how can Japan and the United States work together, how can Japan work in the region peacefully within its constitutional framework to bring security into the region and itself.

Vice Chairman ROBINSON. Thank you.

Cochair TEUFEL DREYER. Commissioner Mulloy.

Commissioner MULLOY. This question will be directed toward Dr. Ott, but if other people have time within the constraints. Let me lay the premise first. And let me quote from testimony. Mr.

Blumenthal, you talk about China's economic growth as part of an effort for comprehensive national power, as you call it.

Mr. Chinworth, you say there is no doubt that China's economic growth presents serious competitive challenges to the United States and other nations. Mr. Percival, you say responsible for the national security of a global superpower now bogged down in Iraq, Washington's policymakers apparently see little beyond North Korea and China when they gaze occasionally eastward.

Dr. Ott, you say there is a strategic contest underway and one player has developed a sophisticated strategy and has collected a number of chips. The other player does not have a strategy and acts like it is unaware the game has started.

I am not out to demonize China. They have interests. I think you've got it right. I think they clearly have some vision. They had a bad 200 years. They are a great civilization and they're back and they want—now, this puts the context in the—here's what I'm always amazed at.

This economic relationship with China in which we're now going to run a \$200 billion trade deficit this year, they figured out how to incentivize foreign corporations to move production, R&D high tech right into China, increased their comprehensive national power. We not only have no political strategy. We have no economic vision or strategy either, and that's what I'm probing.

Do you agree with that? I'm just watching this and I think the United States inadvertently has turned over our policy toward China to the corporations and the multinational corporations. They are not responsible. They're caught up in a system in which they make money to survive and they don't represent the national vision.

I think somehow or other our policymakers have to think about how to change the dynamics of this economic game that's going on right now. Clyde Prestowitz, I think, has written a very good book called *Three Billion New Capitalists: How Our Wealth and Power Are Moving Across the Pacific Ocean*.

So I just wanted to get your comment on that, and then if the others have time.

Dr. OTT. I guess my quick comment is what you describing is a country that operates under free market principles, intends to turn its economic interchange, interactions over to private entities, corporations, and keeps a relatively light government hand on policy.

And you're describing exactly that situation. If there is time, I'll make another comment, but I think I'd like to defer to both Mike and Dan who can comment on the economics of this better than I can.

Well, okay. The other quick comment is a little bit more general point. You may find it of interest. It relates to the point about the three billion capitalists. It strikes me over the long span of history, several centuries, 500 years or so, one of the things we've seen globally is the rise of the West. The extraordinary dominance of the West. Europe first and then North America, Western culture, Western economic systems, Western political institutions.

It's interesting to me to ask the question to myself at least, "Can you reduce the strength of the West to its essence? Is there a magic formula in effect?" I think there is. The magic formula is essen-

tially the marrying of advanced technology and science to complex institutions. It is the ability to create a U.S. Air Force, an Intel Corp., a Johns Hopkins Medical Center, high tech, large complex institutions, using advanced technology.

That is the secret of the West. Most of the non-Western world still has not figured out how to do that. It still remains an incomprehensible secret. The countries we're talking about—East Asia, Japan first, Korea, Singapore, and the Sinoeized cultures of East Asia and in particular the ethnic Chinese and China itself, they have found the keys to the kingdom.

They have figured how to do this. One way to capture that is to ask the question, in the entire Arab Muslim world, how many homegrown multinational high tech, not very high tech, corporations exist, sort of Siemens Corp? When I ask my colleagues who work that part of the world that question, the answer after some pause is, well, there really aren't any.

There are probably 150 of them in downtown Seoul alone. And that captures it. The East Asians have figured out the secrets of the West and they have figured out how to do it. So power, economic growth, economic capability and the power that that creates is, in fact, shifting. My last comment then would be, in a sense that sets the stakes of the relationship with China and China's relationship with East Asia because we are talking about a region that is increasingly the locus of global power. So this is a very high stakes game and we're really talking about how we sort out the relationship with that part of the world with China at the center of it and that in my mind at least, is ultimately what this is all about.

Commissioner MULLOY. You teach at the National Defense University; is that correct.

Dr. OTT. National War College, yes.

Commissioner MULLOY. Fine. Thank you.

Cochair TEUFEL DREYER. We're already out of time. Do you have some really quick comment to make?

Mr. BLUMENTHAL. I suppose I would say that I would agree with Marvin Ott's comments except that China has a tremendous amount of comparative disadvantages economically. So financial know-how, capital markets, managerial know-how, they're certainly producing a lot of engineers and so forth.

But the other point, they're not anywhere near the innovative capacity of the United States and they don't even—they're looking for a brand right now desperately and that's part of has gone on with Unocal and Maytag.

I would say though that there is a lot of state subsidy mercantilism. The Unocal issue is interesting from also the perspective of subsidies and government subsidizing and there's maybe a WTO issue here. So I think that the answer is in terms of an economic strategy if China is a market economy, then hold it to the standards of a market economy. And we have to be much more firm on that issue.

Cochair TEUFEL DREYER. Commissioner Bartholomew has a closing word.

Cochair BARTHOLOMEW. Yes, thanks. Mr. Blumenthal, I couldn't let stand your comment that we've had a democracy strategy for the past 15 years regarding China and I frankly believe that we

haven't had much of a strategy at all regarding China. What we've had is a commercial policy and also would just also note that while the President of the United States is traveling around the world talking about democratic reforms and basic freedoms, he leaves out 1.3 billion people who still live under authoritarian rule.

Thank you.

Cochair TEUFEL DREYER. Thank you. And with that, that closing excellent remark, I declare this panel closed. Gentlemen, thank you so much, and would the next panel please take its place.

[Recess.]

Cochair TEUFEL DREYER. We will follow tradition and start from my left, your right, and start with Dr. John Garver, who is from Georgia Tech where he specializes in Chinese foreign relations and particularly those relating to South Asia. He has been the author of many books and articles on all of these topics and he's spent extended time in China, India, and Pakistan.

Dr. Garver, good afternoon, and thank you for coming.

**PANEL VIII: CHINA'S APPROACH TO SOUTH ASIA
AND THE FORMER SOVIET STATES**

**STATEMENT OF JOHN W. GARVER
PROFESSOR OF INTERNATIONAL RELATIONS
SAM NUNN SCHOOL OF INTERNATIONAL AFFAIRS
GEORGIA INSTITUTE OF TECHNOLOGY**

Dr. GARVER. Thank you, Madam Chairwoman. Let me begin by saying how honored I am to have been invited to testify, and to say that I consider it my duty as a citizen of the republic to provide whatever modest knowledge I have to the informing of U.S. foreign policy.

China's broad objective in South Asia is to expand multidimensional cooperative relations with all of the countries of South Asia. "Multidimensional" means political, economic and military. "All" means the smaller countries of South Asia other than India as well as India. From China's perspective the formation of various types of cooperative relations is a question for the two relevant sovereign governments to decide: the government in Beijing, plus the government in Dacca, Yangong, or Islamabad, or Kathmandu, and so forth. A third party, such as Indian, has no valid say in the matter.

Within this context, over the last five or so years, we've seen an increased Chinese effort to establish cooperative relations with India. There has been an increased India-centric thrust to Chinese South Asian policy. If one wants to put a date on this increased emphasis on India, I would trace it back to the Indian nuclear test of 1998 and the dramatic re-definition of Indian-U.S. relations put in train by the Strobe Talbott-Jaswant Singh talks that began after the tests.

I think there are three broad reasons for this increasing India-centric thrust of Chinese foreign relations. One is economic. The simple fact is that India is a more promising economic partner than the other countries of South Asia. If you look at China's trade with India, it's about seven times China's trade with either Myanmar or Bangladesh. China's trade with Pakistan is about a third of the value of China's trade with India. India is simply a much better economic partner.

China also recognizes that India in some regards is a technologically advanced economy, and that China has a lot to learn from Indian in terms of the creation of computer software. Chinese analysts recognize India's lead in that area, and have occasionally specified that China should seek to learn from and to catch up with Indian in software capability, marrying this acquisition of Indian software skills with China's extent hardware manufacturing capabilities to move China's economy to world-class status. So in terms of comprehensive national power, Indian has a lot more to offer China than do Bangladesh, Pakistan, or Myanmar.

The second broad reason for the increasing India-centric thrust to Chinese foreign relations is the United States. China has been very fearful of possible Indian alignment with the United States. It is widely believed in China that the United States is pursuing a policy of containing China, doing all sorts of things to hedge or limit China's rise. In line with this, the Americans hope to draw Indian into their anti-China schemes. This, many Chinese suspect, is the true if unstated purpose behind the post-1998 improvement in Indo-Chinese relations. One way to counter this U.S. effort to play the Indian card against China is for China itself to foster friendly cooperative relations with India. China's reassurance of its friendship for India serves to minimize India's drift into the perceived American anti-China camp.

The third broad reason for China's increased rive for friendship with India is to lessen Indian objections to the expansion of China's ties with the other countries in South Asia. Over the years, as China has tried to expand cooperative ties with various South Asian countries, Indian has objected and at times taken counteraction to limit that or even thwart the expansion of China's cooperative ties with India's neighbors.

The most extreme example of this was India's levying of severe economic sanctions against Nepal in 1989-90 after Nepal attempted to enter into a military relation with China. More recent and less dramatic example of Indian obstruction involves New Delhi's objection to China's construction of a new port at Gwadar in Pakistan, and Indian refusal to agree to China's many proposals for roads and rail lines across India's northeast, opening the way for expanded Sino-Bangladesh cooperation. From such instances China has learned the lesson that Indian holds many aces it can use to constrain China's relations with other South Asian countries.

As China's power grows, it hopes its friendly, cooperative relations with all South Asian countries will naturally expand. China's strategic problem is how to prevent India from attempting to limit China's ties with India's South Asian neighbors. Moreover, Beijing does not want to be put in the position of having to choose between cooperation with India and cooperation with other South Asian states. Increased friendship with India is a way of avoiding such an either-or choice. In line with this, one purpose of China's drive for friendship with India is to tell New Delhi: don't worry, we're not hostile, we're not unfriendly, our expanding cooperation with Bangladesh, Myanmar, Nepal, etc., isn't directed against you and doesn't threaten you. Therefore, don't try to oppose it, don't try to thwart it, and don't try to penalize China for expanding such cooperative ties with India's neighbors.

Finally, this drive for multidimensional friendship in South Asia, first and foremost with India, takes place within a continuing Chinese commitment to Pakistan. This is one of the bedrocks of China's South Asian strategy: to maintain a balance of power in South Asia, which has been conducive to China's security and interests. This means keeping Pakistan strong. Pakistan has thus been the top recipient of China's economic assistance. Pakistan also offers the only case in which China (in the 1970s) knowingly assisted a foreign state develop nuclear weapons. And in 2001 China undertook new, very large-scale aid projects to Pakistan involving the modernization of Pakistan's railways and the development of a new port at Gwadar in Pakistani Baluchistan.

Those are the broad parameters of China's strategy in South Asia. In the interest of allowing sufficient time for questions and answers, I'll stop here. Thank you very much.

[The statement follows:]

**Prepared Statement of John W. Garver
Professor of International Relations
Sam Nunn School of International Affairs, Georgia Institute of Technology**

China's South Asian Interests and Policies

Expanding Friendly, Multi-dimensional Cooperation

China's broad objective in South Asia is to expand multi-dimensional cooperative relations with *all* the countries of that region. "Multi-dimensional" signifies military ties as well as more innocuous political and economic cooperation. "All" means both India and India's smaller neighbors: Pakistan, Myanmar, Nepal, Sri Lanka, Bangladesh, Bhutan, and the Maldives. India has sometimes objected to China's relations—especially military-security ties—with these countries. Beijing views South Asian countries as "neighbors" with whom it is especially important to have friendly, cooperative ties both to increase China's own economic and political influence and to lessen the ability of potentially hostile powers (currently the U.S.) to injure China's interests.

Economically, China seeks to draw South Asia's resources into China's development drive. India with its fast-growing, industrialized, and relatively affluent economy has become China's strongest economic partner in South Asia. Two-way Sino-Indian trade in 2003 was \$7.6 billion, compared to \$2.4 billion for Sino-Pakistan, \$1.4 billion for Sino-Bangladesh, and \$1.1 billion for Sino-Myanmar trade. During their April 2005 meeting, Wen Jiabao and Manmohan Singh agreed to increase trade to \$20 billion by 2008. While that amount is paltry compared to China's trade with countries like Japan, Germany, South Korea, or the United States, it leads China's South Asian trade by far.

The simple fact is that India produces much more that Chinese firms want to purchase than do Pakistan, Bangladesh, or Myanmar—let alone the small countries like Nepal, Bhutan, or the Maldives. In 2003, China imported \$1 billion more from India than it exported to it, while Chinese exports to Pakistan were three times the value of China's imports, exports to Bangladesh were forty times the value of China's imports, and exports to Myanmar were over five times the volume of imports. While these figures are based on official statistics and do not reflect smuggling (which is substantial in the case of Myanmar), the broader point is that India simply has more to offer China. From India China imports a wide array of mining and industrial products: steel and iron ore, zinc, aluminum and aluminum products, copper and copper products, acids and alkalines, dyes, coloring, alcohol and other chemical products, rubber, plastics, cotton, wool, thread and yarn, leather, and machinery and machine parts. From Pakistan, in contrast, China buys largely cotton, yarn, and leather.

China also recognizes that in key economic-technological areas it has much to learn from India. Chinese analysts recognize India's world-leadership position in computer software creation and aspire to learn from India in this area, meshing these strengths with China's existing strengths in computer hardware production to help catapult China to world-class-economy status. There are no comparable inducements in the case of the other South Asian countries. Pakistan and Bangladesh offer attractive markets for Chinese consumer goods and machine tools. But the ability

of these poor countries to purchase Chinese goods, and to produce things useful to China's booming industry, is limited compared to India's. China has not been able to forge with the South Asian countries a robust foreign energy for Chinese capital goods swap such as it has engineered with Iran. The exploitation of Bangladesh's natural gas deposits could conceivably overcome this structural imbalance, with Bangladesh entering into an energy for Chinese capital goods swap similar to that characterizing the Sino-Iranian relation.

Politically, there are periodic visits between China and the larger South Asian countries at the Minister and Vice Minister level to "exchange views" on various bilateral, regional, and international issues. Beijing seeks to engage South Asian governments in dialogue and cooperation on substantive issues of mutual concern: countering narcotics traffic, smuggling, and terrorism; stabilizing the Karzai government in Afghanistan; or dealing with Tibetan presence and activities in various South Asian countries. Beijing also strives to line up South Asian support on the Taiwan issue: to counter Taiwan efforts to expand ties and to guarantee South Asian neutrality in the event of a U.S.-PRC clash over Taiwan.

Friendship with China is often attractive to smaller South Asian countries living in India's shadow. People in those countries often see ties with China as affirming their independence from India and as a way of gaining bargaining leverage with New Delhi. China's voice in the U.N. Security Council is valued by South Asian governments because of Beijing's occasional willingness to say a few words on behalf of smaller South Asian countries, or even to criticize Washington on behalf of those smaller countries. China has expressed a desire for observer status in the South Asian Association for Regional Cooperation (SAARC) where its ability to offset India will be valued by the other South Asian states.

China views military links as part of the normal repertoire of international cooperation and seeks to expand military ties with South Asian countries. Every year China exchanges with Pakistan, India, Bangladesh, and Myanmar two or three delegations at the Deputy Chief of Staff through Defense Minister level, or from military regions, military academies, or defense industrial agencies. China has recently attempted to institutionalize exchange of views with the larger South Asian countries in the security/military areas. At the political level, there are periodic discussions of regional security issues of common concern. Bangladesh, Pakistan, and Myanmar have been preferred and heavy customers for Chinese military equipment. Chinese training, maintenance, and parts have come with equipment purchases. Exchange of intelligence between China and Pakistan and Myanmar is routine, with Yangong providing important electronic listening posts at several points in the Bay of Bengal/Strait of Malacca area. Chinese naval squadrons have made friendly port calls to Pakistani (1985, 1993, 2001), Bangladeshi (1986, 1995), Myanmar (2001), and Indian (1993, 2001) ports. In October 2003, the PLA-Navy conducted its first-ever joint exercises with the Pakistani Navy in the East China Sea. The next month it conducted joint exercises in the same region with the Indian Navy. China assists Pakistan's missile development and its nuclear energy efforts. Although China's involvement in the latter is under IAEA supervision, the intrinsic fungibility of nuclear materials and know-how makes it likely there is some spillover to Pakistan's nuclear weapons capabilities.

In the past, India has objected to China's military links with South Asian nations. In 1989, for example, a Nepalese attempt to purchase Chinese weapons and initiate an intelligence exchange agreement with China precipitated severe Indian economic sanctions that forced Kathmandu to abandon the objectionable policies. Given New Delhi's opposition to Sino-South Asian military cooperation, Beijing's insistence on forging such links is testament to its determination to become a multi-dimensional power in the region, and its refusal to cede South Asia to an Indian sphere of influence.

China's response to Indian concerns over China-South Asian military cooperation has been to assert that since China does not have aggressive or malevolent intentions, China's military cooperation with India's neighbors does not threaten India. If India is concerned about China's military ties with the smaller South Asian nations, Beijing argues, the proper course is to increase mutual trust between China and India via security dialogues and other such venues. Or if New Delhi is unhappy with Chinese military cooperation with India's South Asian neighbors, China is quite willing to expand such cooperation with India itself. There is no valid reason to object to these friendly, cooperative relations, Beijing argues. In fact, such objections manifest "anti-China" sentiments and hostility toward China, which will be answered in kind by China.

The sort of punishment contained in this implied threat was demonstrated during the eighteen months after India's May 1998 nuclear tests that New Delhi had justified as a response to threat from China. After the Indian tests with their China

threat justification, Beijing cancelled scheduled sessions of the Joint Working Group on the boundary. Chinese media rhetoric became harsher, even resurrecting charges of Indian “hegemony.” Beijing urged Washington and the U.N. Security Council to adopt tough measures against India, and to target mainly India, not Pakistan’s “response” to India’s tests. Beijing hinted it might shift to a more pro-Pakistan position on Kashmir. Beijing’s carrot and stick approach seems to have been fairly successful. India has agreed to open-ended cooperation with China, even while China expands military ties with India’s neighbors.

Minimizing Indian Alignment with Washington

Geostrategic logic dovetails with India’s increasing economic gravity to inspire China’s courtship of India. Chinese analysts are deeply skeptical of the new, far closer, far broader India-U.S. relationship that emerged starting with the Jaswant Singh-Strobe Talbott talks during the second half of 1998. Beijing suspects that a U.S. desire to contain or balance China, to limit its rise and the expansion of its power, are key U.S. motives behind the growing India-U.S. strategic partnership. China’s friendship diplomacy seeks to counter perceived U.S. efforts to maneuver India into participation in nefarious American “anti-China schemes.” This partially explains the “strategic and cooperative partnership for peace and prosperity” agreed to by Wen Jiabao and Manmohan Singh in April 2005.

It is in China’s interests to avoid, or failing that to minimize, negative Indian reactions to the growth of Chinese presence and influence in South Asia. India has traditionally viewed South Asia as its natural security zone and sphere of civilizational influence. The steady growth of China’s influence challenges India’s status. Some Indians also see China as engaged in “creeping encirclement” of India. Others do not attribute sinister intentions to Beijing, but worry about the long-term consequences of Chinese advances regardless of Chinese intentions. Assuaging these Indian apprehensions and preventing India from taking countermeasures is a high-ranking Chinese interest.

India enjoys overwhelming geographic, economic, and military advantages and could punish South Asian states for ties with China that New Delhi views as going too far—as with India’s economic 1989–90 sanctions against Nepal, or as India has occasionally done with Sri Lanka because of the latter’s ties with China. India can also use its influence to counter China’s initiatives—or to persuade South Asian governments not to go along with China’s plans. In other areas Beijing requires India’s active cooperation to expand links with South Asian states: opening and building a railway via the Chumbi Valley, achieving access to India’s rail grid via Siliguri, securing road and rail access to Bangladesh via India’s Manipur state, expanding commercial ties with Bhutan—or with India itself.

China uses several means to minimize India’s adverse reaction to the growth of China’s cooperation with the smaller South Asian countries. Professions of friendship and non-aggression seek to reassure India, as do frequent high-level visits and mid-level dialogues and working groups. Beijing proclaims that it desires friendly relations with all South Asian countries, including India. India and China should be friends and partners, working together for the mutual benefit.

Beijing uses appeals to Third World solidarity to woo India. China argues that both China and India are Asian developing countries oppressed in various ways by the West, especially by the United States and the U.S.-supported current international order. China and India should therefore stand together to construct a new international political economic order in comport with the interests of the Third World. This sort of rhetoric still has considerable appeal in India.

Emphasis on a putative U.S. threat to India is another aspect of Beijing’s wooing of India. According to this line of argument the U.S. military buildup in the Indian Ocean and Persian Gulf since 1979 poses a threat to India. The United States cannot fully achieve its desired aim of hegemony over the Indian Ocean, South Asia, and the world, as long as India remains powerful and independent of U.S. domination. Currently, U.S. hegemonistic efforts are focused on the Persian Gulf (on Iraq and Iran), but if and when those tasks are completed, American hegemonist attention will turn inevitably toward India. Thus in its quest for hegemony, the United States must necessarily challenge and subordinate India. In such a situation, China’s military capabilities in the South Asian/Indian Ocean region would serve to restrain the United States and thus protect India. This author’s sense is that such arguments have thus far met with considerable skepticism in New Delhi.

A final policy used to minimize India’s alignment with the United States has been to encourage U.S. engagement with Pakistan. Chinese encouragement of “balance” in U.S.-South Asian policy under Clinton and endorsement of renewed U.S.-Pakistan partnership in September–October 2001 served several Chinese interests. One

was driving a wedge in India-U.S. relations. At a minimum, Beijing and Washington would now share India's anger at their common support for Pakistan.

Transportation Cooperation

Cooperation in transportation is currently one particularly important form of China's expanding ties to South Asian countries. Three ambitious transportation projects are currently underway and will substantially increase Chinese influence in South Asia.

One project launched in 2001 (prior to the 9-11 attacks) involves a major strengthening of Pakistan's transportation infrastructure, including links with China. China in 2001 committed \$200 million to the modernization of Pakistan's railway system, including the construction of a new rail line linking the port of Gwadar in Pakistani Baluchistan to the main east-west rail line linking Pakistan and Iran. At Gwadar, China committed another \$198 million to build a new, deep water port with capacity eventually equal to the cargo handling capacity of Karachi, a port currently carrying ninety percent of Pakistan's trade. Chinese work on the new Gwadar harbor began in March 2002. China is also working with Pakistan to expedite customs procedures over the Sino-Pakistani highway, and to permit Afghanistan teamsters (an important element in the regional transport system) to utilize Chinese and Pakistani highways to create a stronger regional trade system. In 1999 a new extension of the Xinjiang railway reached Kashgar about 500 kilometers via the Karakorum highway from the Sino-Pakistani border. The Asian Development Bank is supporting construction of a trans-Kyrgyzstan highway. When completed, and when eventually transformed as planned into a trans-Kyrgyzstan railway, this line will further strengthen China's links with Central Asia including Afghanistan.

The second transportation project involves construction of a railway from Golmud in Qinghai province to Lhasa in Tibet. Attempted construction of this rail line in the 1970s was stymied by financial and technological difficulties. Scheduled for completion in 2007, the rail line will link Tibet by rail to China proper for the first time. The main purpose of the railway is to integrate Tibet more closely to the Chinese economy, but this in itself will have a major impact on China's influence in Nepal, Bhutan, and (to a lesser extent) on the Northeast Indian states. Chinese goods, investment, migration, and tourism in these Himalayan fringe-lands will increase. A Tibetan economy tied more closely to China will significantly increase China's ability to provide a viable economic alternative to India in the event of another Indian embargo akin to the 1989-90 embargo against Nepal. Were a government to take power in Nepal dedicated to a revolutionary restructuring of Nepal's economic system, the heavy costs of a deliberate break with India and economic alignment with China might be deemed acceptable (to an unelected revolutionary elite) for the sake of "national liberation."

There is no evidence that China supports the Maoist insurgency in Nepal. In fact, China has carefully disassociated itself from that insurgency. But were the insurgency to succeed and a Maoist government take power in Kathmandu, China would almost certainly move forward in expanding friendly, multi-dimensional cooperative relations with that government. China would respect the "choice of the Nepali people" in altering their social system and government, and work to build friendly, cooperative ties with its new neighboring government. Under such conditions, control over India's northern Himalayan glacis could shift from India (who founded such control in a 1950 treaty) to China. This would be a significant shift in the South Asian balance of power in China's favor.

Southerly extensions of Golmud-Lhasa railway are likely over the next decade. Beijing has discussed two possible routes with South Asian governments. One is construction of a rail line along the general alignment of the existing Sino-Nepali highway to Kathmandu. The second is a tie-in with India's rail system at Siliguri via the Chumbi valley. Securing Indian agreement to construction of a modern road and eventually a rail line via the Chumbi valley will require Chinese recognition of India's annexation of Sikkim. It will also require further easing of Indian apprehensions over China's growing presence in the Bay of Bengal region. This is another motive inspiring China's friendship diplomacy toward India.

China's third transportation project entails constructing an inter-modal (road, rail, and water) transport system (dubbed the "Irrawaddy Corridor" by Chinese analysts) linking Yunnan province with Myanmar. Roads between Kunming and Bhamo and Lashio in northern Myanmar have been modernized. Construction of a railway between Kunming and Lashio has been designated a portion of the U.N. Economic and Social Committee for Asia and the Pacific's Trans-Asian railway—a result of Chinese lobbying. Large portions of the Irrawaddy River have been dredged with Chinese support. A new highway is being constructed with Chinese support from

Minbu on the middle Irrawaddy to Kyaukpyu on Ramree Island in the Bay of Bengal. This transport system has already had a major impact on China's commercial presence in Myanmar, and via Myanmar's ports, a significant impact on China's participation in the world economy.

The impact of the Irrawaddy Corridor on China's interests with South Asia derive from the fact that northern Myanmar is the natural transport corridor for trade between southwest China and Bangladesh and India. Most of China's trade with India and Bangladesh will continue to move by sea. But Sichuan, Guizhou, and Yunnan provinces have considerable industry, and need to expand foreign markets for that industry if they are to replicate the developmental success of China's east coast. Yet these western provinces suffer the handicap of lying near the end of long and crowded rail lines leading to China's east coast harbors. Efficient road and rail connections via northern Myanmar and India's northeast and Bangladesh would be a major boon for China's poor southwestern provinces.

Thus, in 1999 Yunnan province, with Beijing's support, launched what became known as the "Kunming initiative" designed to expand regional trade and create a strong regional trading system. Transit issues are key here. Trade between Yunnan and Bangladesh will need to transit Myanmar and Indian territory. Myanmar is apparently willing to serve as a trade corridor. India, however, has shown great reluctance about seeing a further enhancement of China's commercial weight in the Bay of Bengal region. This means that Beijing has a major interest in reassuring New Delhi of its friendly, non-threatening intentions so as to secure Indian agreement to Chinese trade using the Indian rail system and transiting Indian territory to reach third countries. Beijing's argument is that this is a win-win situation that will bring economic prosperity to all participants.

While the primary function of these new overland transport links with South Asia is commercial and related to China's efforts to develop its western provinces, there is also a latent security function related to South Asia. In the event of a Chinese clash with the United States over Taiwan which became protracted and in which Washington deployed its superior naval capabilities to restrict China's maritime imports of munitions and/or energy, China could use the new South Asian routes to circumvent U.S. blockades. Vital goods and material could flow to China via Pakistan, India, and Myanmar. Would the United States be able and willing to extend a blockade to ports in those neutral countries? If the answer were "yes," Washington would thereby increase its number of opponents and its expenditures, serving well a Chinese seeking victory via protraction and enervation. If the answer were "no," vital supplies could flow to China over these lines weakening the effectiveness of a U.S. blockade.

China's Energy Security and South Asian Sea Lanes of Communication

China's spiraling demand for energy, plus its growing dependence on imported petroleum, have made Beijing increasingly concerned with ensuring the uninterrupted flow of oil at reasonable prices. The Middle East plus North and East Africa provide well over half of China imported oil. Virtually all of that oil moves to China by tanker across the Indian Ocean.

Beijing confronts several potential threats to its trans-Indian Ocean oil supply. A confrontation between Iran and the United States could lead—either via sanctions or by military actions—to the restriction of oil shipments through the Strait of Hormuz. An Indian-China conflict might escalate into the naval dimension. India might respond to defeats by the PLA in the Himalayas, or to Chinese support for Pakistan in the context of a "fourth round" between India and Pakistan, by using India's naval supremacy in the Indian Ocean to sever China's vital oil imports. Then there are scenarios of U.S.-PRC conflict over Taiwan that escalated into U.S. naval blockade of China. None of these contingencies is a high probability, yet military institutions everywhere devote attention to remote but potentially dire scenarios.

In any of these contingencies the ability of PLA-N warships to escort vessels carrying oil from Middle Eastern ports to China might be part of an effort to prevent hostile powers from interfering with delivery of China's oil supply. Development of robust overland transportation systems between Yunnan and the Bay of Bengal, and between western Xinjiang and Gwadar could substantially strengthen the PLA's ability to sustain intense military operations in the eastern and western Indian Oceans. As a neutral power in a possible U.S.-Iran confrontation, China would enjoy the right under international law to continue trading with both belligerents. But historically neutral powers have often found protection by military force essential to upholding those legal rights. Were China's leaders to conclude PLA-N escort of China's oil commerce across the Indian Ocean necessary, the newly created transport lines via Myanmar and Pakistan could become quite useful. In terms of possible Sino-Indian conflict, the PLA-Navy is substantially superior to the Indian

Navy in terms of overall tonnage and ship numbers, but the latter enjoys overwhelming geographical advantages when operating in the Indian Ocean. If the PLA-N could obtain bases on the Indian Ocean littoral (perhaps at Gwadar and Kyaukpyu), and link those forward bases to China by robust road and rail lines, India's geographic advantages would be substantially diminished to the PLA-N's advantage.

China and the South Asian Balance of Power

China has an interest in maintaining the existing balance of power between India and Pakistan. The existence of a strong and confident Pakistan able and willing to challenge India confers important advantages on China. Politically it hobbles India's efforts to act on the global stage as China's equal. Militarily, it forces India to confront the possibility of a two-front war, thereby compelling it to divide its military forces. This is the geopolitical rationale for China's large and long-standing economic and military assistance to Pakistan. It is *possible* that one reason why Beijing is not in a hurry about resolving the boundary dispute with India is that it would fundamentally ease India's two-front problem, intensifying Indian pressure on Pakistan.

China's interest in keeping Pakistan strong was one reason why Beijing endorsed Islamabad's re-engagement with the United States after 9-11. While that re-engagement diminished somewhat the potential utility of Pakistan and Gwadar as a logistics "back door" for China in the event of confrontation with the United States or India, it also brought Pakistan in from a situation of increasingly dangerous isolation. Pakistan's close ties with the Taliban in Afghanistan plus the growing Islamization of Pakistani politics and the steady deterioration of Pakistan-Western relations since the mid-1990s, posed an increasing danger of Pakistan's isolation, perhaps even designation by the international community as a "rogue state." This would have been a serious blow to China's interests, and to the extent that U.S. re-engagement with Pakistan could move Pakistan in a different direction, it served China's strategic interest in a strong Pakistan that constrains India. U.S. engagement with Pakistan also made development of India-U.S. strategic partnership more difficult, and diffused Indian anger over China's own strong military and nuclear links to Pakistan.

This is not to say that Beijing's interests are served by confrontation between Pakistan and India. Beijing's objective, as noted earlier, is to develop cooperative ties with *all* the countries of South Asia. Confrontation between Pakistan and India would put Beijing in the unfortunate position of having to choose between Islamabad and New Delhi. Failure to support Pakistan could endanger China's fundamental interest in keeping Pakistan strong and independent of Indian domination, and threaten China's strategic partnership with Pakistan. Alignment with Pakistan, on the other hand, would spoil China's ties with the major South Asian power, India, and possibly push that power further into alignment with the United States. In this sense, peace between India and Pakistan is in China's interests.

In the event of Pakistan-Indian confrontation, China will piggyback on the peace diplomacy of the United States and other powers, adding its voice to efforts to restore peace and the status quo ante as quickly as possible. A Chinese tilt toward Pakistan but well below the level of threatened belligerency on Pakistan's behalf, would be virtually certain, but only in the event that India roused itself and threatened to decisively subordinate Pakistan (perhaps in the aftermath of a nuclear exchange) would Beijing move toward actual co-belligerency on Pakistan's behalf.

Conclusion

China's omni-directional friendship policy in South Asia is not cant, but serves Chinese interests well. Chinese relations with other South Asia nations will be more robust and stable if India views those ties as non-threatening. A friendly and cooperative relation with India will give China a stronger position in South Asia than would a conflictual Sino-Indian relationship. An economic, diplomatic, and even military partnership between China and India, surrounded by similar partnerships between China and the other South Asian countries—a sort of Asian zone of friendship and cooperation—would maximize Chinese influence in South Asia, and ensure that threats to China did not emanate from that region.

China's omni-directional friendship diplomacy toward South Asia is working relatively well. China's broad strategic objective is to persuade India to look benevolently on an open-ended and expanding Chinese economic, political, and military presence in South Asia and the Indian Ocean, to eliminate suspicion in Sino-Indian relations, and to transform India into China's partner. In this way the rise of China in Asia will not lead to Indian efforts to countervail China in coalition with the United States. But the conversion of India to friendship with China is to be done

without making concessions to India on the status of Tibet, the Sino-Pakistan strategic link, or by restricting China's expanding military, security, and transportation ties with other South Asian nations.

China's optimal outcome would be open-ended, growing political, economic, and military cooperation between China and *all* the South Asian countries, with India accepting an open-ended expansion of Chinese influence in that region and learning to live comfortably under China's benevolent protection. India would gradually evolve into a key Chinese partner in South Asia. China's intention, its objective, in South Asia is most definitely *not* to establish dominance over that region, or draw it into some sort of Chinese sphere of influence. That, however, might be the outcome over a period of twenty or thirty years.

Cochair TEUFEL DREYER. Dr. Garver, we are much in your debt for (a) being brief and (b) saying it all in a short period of time. Thank you.

Our next witness is Professor Madhav Nalapat. We have had a number of people giving testimony who came from a far distance, but I think you have everybody beaten in terms of frequent flier miles, perhaps second only to Mr. Goble sitting next to you. Professor Nalapat is Professor of Geopolitics at the Manipal Academy of Higher Education, which is India's elite private university.

He focuses on India's relation with China and he has himself lectured at Beijing University and Fudan University, and he is a member of the advisory board of the India-China-America Institute. Professor Nalapat, thank you.

**STATEMENT OF MADHAV "M.D." NALAPAT
PROFESSOR, MANIPAL ACADEMY**

Mr. NALAPAT. Thank you, Commissioner Dreyer. I am honored to be here and I think it's very relevant that you invited someone from as far away as India because we are becoming quite relevant to the security of the United States. I'd like to point to our neighborhood.

We neighbor Pakistan and Nepal, which are two states, which could be considered as potentially failing states. We neighbor Afghanistan, which I think is on a respirator. If it's not failing, it's on a respirator. We are neighbors of the PRC and Myanmar, and I don't think either the PRC or Myanmar are fully democratic as yet.

We neighbor Bangladesh and the current government there, large elements there, are very clearly keen on radicalizing that country despite 9/11 and despite the lessons that should have been learned after that. We are next to Sri Lanka where there is a tremendous amount of ethnic unrest. In all these countries, the fundamental interests of the United States and India in stability, in democracy, in fighting terrorism, in economic growth—coincide, and we don't see any conflict of fundamental interest between the United States and India.

Now, coming to the specific question of China, I've been going to China quite off and on, and I would like to tell you that I have the, as an Indian, tremendous respect for the Chinese people, the Chinese culture and civilization, which I believe is among the greatest in the world. Can rank with the Romans, the Greeks.

It can rank at that level, but it's a riddle to me and it's a riddle to many of us.

For one thing, they call for a multi-polar world, but they work in a sense for a unipolar Asia. In South Asia, they warn against

the Japanese, in South Asia, my part of the world, they warn against Indian hegemony, Indian expansionism, Indian great power status.

There are numerous citations to that effect in publications that are both of technical journals as well as others. In East and Southeast Asia, they warn about Japan, that Japan is an aggressive power. That it hasn't forgotten the past, et cetera, et cetera.

In Central Asia, East Asia, South Asia, frankly, it warns about the United States, about what it calls the unipolar world. The unipolar world is shorthand for the United States. So, on the one hand, it's a question of support to a multipolar world, but on the other hand, it doesn't want any competition to itself in any of these regions.

And it has a very definite diplomatic policy of trying to degrade the influence of those countries like India, Japan, United States that it sees as perhaps supplanting it in course of time.

Now, one example. You know, we had a meeting of the Indian, Chinese and Russian foreign ministers. Now I'm informed on fairly good authority that our Chinese friends made it very clear that India should be a front-line state in fighting "unipolarism." We should be a very strong front-line state in fighting against "unilateralism." Now, China is a much bigger country than we are. We are a very poor and weak backwards country.

Now, if they would like to fight unipolarism and all that, they should be the front-line state and not us. So this kind of suggestion confuses us.

Secondly, the Chinese keep talking about the need to eliminate proliferation. They have been very vociferous about our nuclear tests. At the same time, you have in Pakistan this A.Q. Khan network. It's very hard to believe that this one gentleman created the nuclear industry in Pakistan. It's very, very hard to believe that this gentleman by himself or with a few rogue scientists in the Netherlands or Germany could create this entire network.

The belief of many of us is that Pakistan became a nuclear weapons power almost entirely because of help from China. The same thing in my view takes place in North Korea. I don't believe a country with the economic skills and the mechanical infrastructure of North Korea could have become a nuclear power without massive external assistance.

At the same time, they are against proliferation. All right. Now India is a friend of China. John, my old friend, Dr. Garver has been talking about India and China for a long, long time, and we have signed a lot of CBMs with China, military-related CBMs right from '98 onwards, from '88 onwards. But we find a continuing series of Chinese incursions across the frontier.

It's another matter that the government of India is keeping information about most of these from its own people for the fear that this will again ignite anti-China passion the way we had in the 1960s, which kind of propelled the government at that time to take certain steps which I regard as having been unwise.

But the fact is that these incursions are taking place almost on a monthly basis across the border that the Chinese are refusing to delineate and refusing as yet to formally define.

Now, the war on terror. They claim they are very much on board on the war on terror. Now we know something on the war on terror because we have been fighting that for 22 years. We had been active in, for example, fighting jihadists, who have been based in London, who have been based in Vancouver, who have been based in San Francisco. They have actively created terror in India, and we are extremely happy that all these different countries now realize that terrorism anywhere is an evil. But on this, we find the approach of China very simply is Uighur and Xinjiang centric.

If there is no problem with the Uighurs, with the Xinjiang people, they're not really bothered what happens to the rest of the world. That could be one reason why the Organization of Islamic Countries, that great organization, has several times condemned India but has never condemned China. Of course, I wouldn't like to mention the name of Mr. Osama bin Laden here, but I don't recall any statement in which he has attacked China.

He has mentioned India. He has mentioned Israel. He's mentioned the United States. I can't recall a statement in which he's mentioned China. It could be forgetfulness. It could be something else.

Now, the question of a peaceful rise. If you are talking of a peaceful rise, then I am a person who admires the Chinese people, am an individual from India where frankly we are not concerned about regime change. We'd be perfectly happy if our interests were protected and the current regime in China goes on for 999 more years. We have no problem. But why are they creating military assets across the region? Why are they going and forming, setting up a base in Pakistan, setting up a base in Myanmar, talking informally to our old friends, the Iranians, talking to our friends in Mauritius about military visits and about setting up bases, if they are talking about a peaceful rise?

If I go to dinner at a friend's house, I don't bring along a loaded pistol. I go unarmed, and I'd like to point out that on the India-China border, the standing informal rules are that many of our patrols go completely unarmed to show our benign intention toward the Chinese side.

All right. We have a friendship policy towards India. But at the same time they demonize India in the publications of CSS, CICIR, People's Daily. You name it, there's always a demonization of India as a hegemon, as an irresponsible power and as various other things, which, since we're not X-rated, I wouldn't like to specify that. This is not compatible with a policy of friendship to India.

Now, you have a situation concerning the United States, of course. We're happy to say that just as within a certain bunch of people, the U.S. is the "great Satan," and Israel is the "little Satan," in Asia, the U.S. is the "great Satan" and India and Japan appear to be the "little Satans." Because we are equally condemned.

Now, China goes to Iran. They go to Venezuela. They talk about the United States. They go to Southeast Asia. They talk about the United States. They warn about India, that India is now becoming a lackey of the United States. They say, "Be careful of these guys. They're not independent anymore."

Now, if you are friendly, then why go into this all this kind of rhetoric? Why go into all this informal diplomacy? I would like to

stress that I come from Asia. In Asia, the spoken word is much more important than the written word. In my society, we have the entire Indian nuclear program, where key decisions are all taken orally. Even today in India, key national security decisions are taken orally, which is why American scholars find it so hard to come to what we regard as realistic conclusions about India.

Well, they in China talk about free trade, but then they seek to block access. They have tried to block access to Indian oil companies in Myanmar. My information is that they're trying to block access in Cambodia to some U.S. interests that are moving into Cambodia. They're using, they're talking to Venezuela, they're talking to Iran, and I've said this, I've written this. In many parts of the economy, world price is determined by cost. In the Chinese system, the cost is determined by the price. They have a very clear system of competing at a price that they can compete with. So I'd just like to sum this up by saying that we do want a peaceful rise of China. But we find that several of these actions that we are talking about conflict with the stated desire of the Chinese government for a peaceful rise.

We don't see China as a status quo power. We see China as a power out to change the status quo and not necessarily to our advantage.

I'd just like to end by saying that about three years ago I wrote an article in the Asian Wall Street Journal about the "new appeasement." Right from 1995, I've been coming to the United States and talking to people in State Department and other departments about Wahabi problems and how Wahabism can be an evil. I found a conspiracy of silence, so to speak, to say that this doesn't exist, that this problem doesn't exist. That Wahabis are basically benign people.

Finally, unfortunately, a situation came in which people realized they are not benign. I would like to submit that so far as China is concerned, all friends of the Chinese people will need to avoid a conspiracy of silence about China, will need to confront China openly about its problems, about its faults, so it can go to genuine reform, and we can avoid a situation that took place in Wahabism. I'm sorry to say the Western world was the strongest supporter of Wahabism and is today the worst tortured, the most tortured because of that.

I'd like to say that there should be no appeasement of these tendencies. We should call a spade a spade and that's the only way to reform.

Thank you.

[The statement follows:]

**Prepared Statement of Madhav "M.D." Nalapat
Professor, Manipal Academy**

"China's Great Game"

The Chinese Communist Party (CCP), and consequently the Peoples Republic of China (PRC), has considered itself in a state of war since its inception. Sometimes its focus is on an internal rival, such as the Kuomintang, alternatively an invading force, such as the Japanese army, or a force that has invaded an ally, such as U.S. forces in Korea. Or they could be "upstart" countries such as India (1962) or Vietnam (1979). What remains a constant is the state of siege. For such a mindset, the range of allowable options in the pursuit of its objectives is vast.

Although China has taken a strident tone against U.S. “unipolarity,” the reality is that the objective of the CCP is itself to create a unipolar Asia with the PRC at its core. This would in time enable the PRC to displace the U.S. as the global unipolar power. In Asia, early on, the CCP saw Japan and India as the two major obstacles towards primacy in the continent, thus setting in train a series of policies—including strategic assistance to North Korea and Pakistan—designed to weaken the ability of the two Asian democracies to reach a level where they could overwhelm the “Comprehensive National Power” (CNP) of China. While Japan is being kept off-balance by the continuous rousing of prejudices caused by its past militarism, the containment of India in the South Asia box having failed, the new policy is to prevent an alliance between India and the U.S. that would add a powerful third strand to the existing U.S.-Japan alliance. The February 24, 2005 statement by a Chinese Foreign Ministry spokesperson against the reported U.S. proposal to sell anti-missile systems to India is an example of the sensitivity that this improving security relationship engenders in Beijing. Ironically, the spokesperson bemoaned the risk of an “arms race” in South Asia that would be caused by the U.S. sale, forgetting the reality that the PRC is the principal supplier of armaments to almost all the countries of South Asia, with the exception of India, to which it is unwilling to transfer military equipment. Interestingly, the beginnings of military cooperation between the U.S. and India is being described as “non-combat military action” by Chinese strategists, who also claim that this represents “a threat to the peripheral security of China.”

The Chinese media, both under the PRC Constitution as well as that of the CCP, are legally obliged to further the aims and interests of the CCP and the PRC. Despite increasing talk of a strategic partnership with India, the regular Chinese media have continued to carry reports about the “hegemonistic” ambitions of India, and are eloquent about its desire to “dominate” South Asia and “form military alliances” with the countries of Southeast Asia. While the PRC has worked hard to remind the countries of Southeast and East Asia about Japanese wartime atrocities, a like campaign has been carried out in South Asia, that paints India as an aggressive, predatory power out to subjugate the region. In both situations, Beijing has put itself forward as the “balancer,” the cultivation of which can weaken the attempted hegemony of those undesirables, Japan and India. It is not accidental that both North Korea as well as Pakistan has been enabled by China to become nuclear and missile powers. The first helps to box in Japan, the second India.

In Pakistan, the PRC has been helping its nuclear ambitions since the 1971 Bangladesh war. Although successive governments in New Delhi refused to weaponize the nuclear device first exploded at Pokhran in 1974, conclusive intelligence that China was transferring tested design data of some of its nuclear weapons to Pakistan forced the hand of Prime Minister Rajiv Gandhi, who ordered a weaponization programme in 1985. While some of this is carried out under false flags and specially-created “independent” entities, what follows is a partial list of recent PRC-sourced assistance to Pakistan’s nuclear programme:

- (a) The construction of the Kundian Nuclear Fuel Complex with substantial PRC assistance, including the supply of components and technology.
- (b) The supply of a large number of ring magnets to the Khan Research Laboratories at Kahuta, to be used in centrifuges for the enrichment of uranium.
- (c) The construction of the nuclear reactor at Kushab, for the production of plutonium.
- (d) Technical assistance in the manufacture of nuclear triggering devices, thus enabling Pakistan to move further up the ladder towards full weaponisation of its existing nuclear device capability.

As late as the latter half of 2004, those in India monitoring developments in Pakistan reported a continuing flow of (PRC-source) nuclear weapons-related material and components into Pakistan. These transactions have been clandestine and therefore denied by Beijing. The reality remains that it is mainly Chinese assistance that has enabled both North Korea and Pakistan to become nuclear powers, and that the continuation of such help would enable them to operationalise these capabilities. In this context, it is pertinent to note the recent transfer of 160-kilometre range missiles to Bangladesh, as well as the public signing of the Nuclear Cooperation Agreement between China and Bangladesh just days before Prime Minister Wen Jiabao visited India. The North Korean and the Pakistan experience indicates that the CCP has a very elastic definition of the term “peaceful” (which was how the Bangladesh agreement was described), and that a strategy of plausible denial based on the creation of “independent” agencies and corporates is followed by the PRC in much the same way as the Pakistan army “rolls up” a jihadi outfit that has come under inter-

national scrutiny but immediately replaces it with a clone that in most cases has the same personnel.

Some dismiss the military modernization now being carried out by the PRC as being of too little import to pose a threat to the security interests of the U.S. As 9/11 has shown, quantitative and even technical inferiority may not provide protection in a situation where unconventional tactics, alliances and weaponry get used. All-out damage is not needed to impel a cease-fire, merely a much lower threshold of loss or risk. That the PLA is at present comprehensively inferior to the U.S. armed forces in terms of weaponry does not therefore mean that the latter cannot be put into an unacceptable situation by the former.

The recent development of the Dong Hai-10 (a land-based cruise missile) and the successful test-firing of a JL-2 nuclear missile from a Golf Class submarine indicates that the PLA is rapidly coming of age, at least in the context of the two theatres where conflict between itself and U.S. forces is most likely, the Taiwan Straits and North Korea. Some military planners in Beijing may see the deployment (expected by 2008) of the 094-Type nuclear submarine with JL-2 missiles with a 350-kg warhead and a range of nearly 8,000 kilometers as being sufficient to deter a U.S. intervention in the event of an attack on Taiwan, even without full deployment of the new generation Dong Feng 31A ICBMs.

In the specific case of India, among the more worrisome developments concerning the PRC are:

- (1) The passing of an Anti-Secession Law by the National Peoples Congress in March 2005, that can in practice be used not only against inhabitants of Taiwan but Tibetans residing in India as well as Indian nationals in places such as Arunachal Pradesh that are not recognized by the PRC as part of the Union of India.
- (2) The steady increase in the number and quality of the PLA's armory of short- and medium-range ballistic missiles, much of which are within range not just of the Indian landmass but a wide swathe of the Indian Ocean.
- (3) The beginning of missile and nuclear cooperation with the avowedly Islamicist regime in Bangladesh, coming on the heels of the development of Pakistan into a nuclear and missile power. C802 missiles are now being supplied to the Bangladesh navy, while elements within the Bangladesh army talk of "Going the Pakistan way" to meet the conventional superiority of India.
- (4) The development of Gwadar in Pakistan and Sittwe in Myanmar as PLAN bases, with the likely future addition of ports in Bangladesh and possibly Iran, which would give China strike capability in the Indian Ocean, a region that it considers key to its energy security.

Gwadar, in particular, can become the hub for operations that target Central Asia, West Asia and North Africa. It is close to the Jinnah Naval Base, in Ormara, with its warship and submarine berthing and maintenance capabilities. Much of the port is being constructed by Chinese engineers and workers and it is reported that the relevant PRC entities have also taken control of perimeter security within the zones they operate in. Apart from its military uses, Gwadar can also serve as a junction for Central Asian oil and gas for China. Interestingly, the entire complex was designated as a "Sensitive Defense Zone" by Pakistan.

- (5) The steady improvement of the HATF and SHAHEEN series in Pakistan, with continuous clandestine or indirect PRC involvement. This is multiplying the risk that some or the whole of this weaponry may fall into overt jihadist hands in the future. Despite repeated denials, information on the ground indicates a continuation of PRC-sourced technology, materiel and technical manpower to Pakistan's missile programme.
- (6) The continuing patronage of anti-India elements within the South Asian region, such as, for example, the setting up of a "Nepal-China Study Centre" staffed with India-phobic Nepalese and which has the majority of its workstations along the India-Nepal border rather than the Nepal-Tibet border. Interestingly, while the Maoists in Nepal have been vituperative towards the U.S. and India, they have thus far refrained from any criticism of Chinese help to King Gyanendra, the same way that Mr. Osama Bin Laden has yet to condemn the activities of the Public Security Bureau in Xinjiang. Has there been a price tag to such silence?

An interesting scenario would be if the PRC were to adopt towards the U.S. a strategy similar to that followed by Pakistan against India for decades, which is "bleeding the (larger) enemy through a thousand cuts," by covertly stoking up hotspots that would tie up U.S. resources, thus leaving less for dealing with the principal Chinese challenge, to Taiwan and to the need for regime change in North Korea. Is it a coincidence that the PRC has been active in the provision of defense-

related supplies to countries such as (Sadammite) Iraq, Iran and Sudan, just as it has been lavish in the giving away of its nuclear and missile technology to regimes that are authoritarian?

In its preoccupation with a possible Indian thrust in its soft southern underbelly in the event of war in East Asia, the PRC would like New Delhi to commit itself by treaty to not allowing either itself or its territory to be used against China in the event of such a conflict, a commitment already made explicitly by Pakistan (through the Treaty of Good-neighborly Relation and Cooperation), renewed by both countries for a further term of 20 years in April 2005. There is wariness in Beijing at the prospect of a U.S.-led security alliance in Asia that could potentially intervene in such a conflict, and which would include India. The high decibel opposition even to newspaper reports of the suggestion for an "Asian NATO"—together with the premise beginning with the 2002 PRC Defense White Paper that there is a shift from a "largely tranquil world" to one with a "realistic threat of war"—indicates that the possibility of war and plans to prosecute it are regarded by the PLA and the CCP leadership as appreciable.

In Asia, unlike in societies that are more formalistic, the deciphering of the intent of an interlocutor is done only after analyzing not simply the spoken word but the manner in which it has been expressed, the body language, the expression on the face, and other telltale indicators of true intent. In the case of the PRC, there is a mismatch between "words" and "body language" that leads to questions about intent and aims. China need not be "contained." It should; however, be "constrained" from following the war-inducing policy of some other countries in the 1930s. A realistic policy towards the PRC would help prevent Asia from going the way Europe did in that dismal time.

Cochair TEUFEL DREYER. Thank you very much, Professor Nalapat. Next we have Professor Paul Goble, who back at a time when he was at the University of Chicago and everybody else was studying missile throw weights, decided he would like to learn every single language of all the Soviet States, and he'd actually done it. After a career in the CIA and the State Department, he has become a professor at the University of Tartu, Estonia where no doubt he has further perfected his Estonian.

Mr. Goble.

**STATEMENT OF PAUL GOBLE
PROFESSOR, EUROCOLLEGE, UNIVERSITY OF TARTU, ESTONIA**

Mr. GOBLE. Thank you. We do work very hard on languages, but there are more than that, and certainly Chinese is not one of my languages so I very much appreciate having a chance to talk about China. The only time you hear China referred to in Estonia, I fear, is when people repeat the old Soviet-era joke, what will conditions be like in the Soviet Union in the year 2000, with the answer being we don't know, but conditions along the Sino-Finnish border should be quiet.

For the last half century, the American approach toward Moscow and Beijing has typically been profoundly affected by the approach that each of these capitals has had for the other. You can go right through from the '50s on that that's been true. Now, given the continuing decline of the Russian Federation and the dramatic rise of China economically, politically and militarily, we are again forced to consider how we should craft our policies toward the two, how much they should be linked one to the other as they have typically been, and what we should do to contain or deal with, how we should deal with, not contain necessarily but how should we deal with China?

Consequently I very much want to commend this Commission for holding hearings and also to thank you for giving me the opportunity to speak before you. It is my impression that most of us are

driving by the shifting headlines in this and other areas. One day we are told about the positive signs coming out of China. The next we are told about negative ones—and that goes for China's relationship with the Russian Federation as well.

Consequently in the time I have, I would like to look very quickly at some of the underlying forces at work because I think they are going to cause us to see more kaleidoscopic change in those relationships and those headlines. I'd like to begin by making the now classical but often ignored observation of some of the most cabled diplomatists that countries do not have permanent friends or enemies, but they do have permanent interests.

That goes for the Russian Federation. It goes for China and it goes for something that each sometimes forgets. I want to argue here that the underlying interests of the Russian government and the underlying interests of the Chinese government will over time both push them together and drive them apart and that the assumption that they will work in only one direction in the next decade or the next 100 years is profoundly wrong.

In order to make my remarks as brief as I can, what I'd like to do is to simply list five areas where Russian and Chinese interests converge and five areas where they are very much at each other's throats, as it were, because I think that we're going to see these various interests play out and it would be a mistake to assume that everything is moving in a single direction.

First, both China and the Russian Federation are clearly interested in asserting their power against the United States. Moscow because it finds itself in such a position of decline and the Chinese because they believe this is part of what's needed in order to move forward.

The reasons are different and therefore this too will cease. Second, both of these countries are terrified of instability. They may be doing things that promote instability, but they are ultimately afraid of instability coming back into their own backyard.

The Russians face serious instability across their southern tier and the Chinese do in Xinjiang. And while it did not get much reporting in this country it is worth knowing that when the so-called Revolution in Kyrgyzstan took place, when the people from Osh got as far as Bishkek, the first thing they did was not to attack government offices, but to burn businesses which had Chinese owners. The Chinese were very alarmed by that because it called attention to how much Chinese penetration there is in Central Asia already and how much opposition there is to that.

Third, both Russia and China are concerned as are we all with the possibility of more nuclear proliferation, although again I think both of them have done things—the Russians in Iran, and the Chinese has as been already pointed out elsewhere to promote the very thing they say they are against. So I wouldn't go too far.

Fourth, each is particularly frightened by Islam. Moscow, as you should know, is already the largest Muslim city in Europe, and the Russian Federation will have at least an ethnic Muslim majority by 2030, less than 25 years from now.

Beijing has within its borders far more than 100 million Muslims, so both of these countries have a very, look very closely on the world of Islam and with some fear.

And fifth, each is very clearly interested in restricting the rise of new powers independent of themselves. The Russians are concerned about the EU. They use the Baltic countries, one of which I live in, as a lever against the EU and the Chinese as has been pointed out about India.

Now where do the interests diverge? First of all, the Russian Federation is a declining power while China is a rising power. That tends to be forgotten here, but Russia is a declining power. Its economy today is about the size of that of the county of Los Angeles and the joke in Russia today is that under the Soviets they promised that the Soviet people would catch up and surpass the Americans, but now under President Putin, they promised that they will catch up and surpass the Portuguese.

This is a very, very troubled country and the fact that it is declining and the fact that it is next door to a country that is on the rise inevitably sets up conflicts.

Second, they have two fundamentally clashing economic interests. Russia is an exporter of raw materials—petrochemicals now and for the next ten to 15 years, and then water. I would urge you to pay attention to the water issue because China is going to run short of potable water and the Russians are one of the big two in the waterpowers of the future.

China is an importer, which of course means they have to cooperate up to a point, but also China is an exporter of goods, and one of the things about the population over the border is mostly shuttle-supply of goods rather than any colonization.

Third, population densities on the two sides of the Sino-Russian border are remarkably different. The Russian side of the border, assuming you ascended 50 miles in, is currently at rates not seen since the Neolithic period. The collapse of the Russian nation in Siberia and the Far East is that dramatic, while those on the Chinese side are large and growing.

But the economic situation on the Russian side of the border is sufficiently bad that the likelihood and the climatic condition sufficiently difficult that the idea that the Chinese are about to march north, I think, is vastly overstated.

If you look at the media and the Russian Federation, and you track down the citations of articles in the West that talk about the Chinese seizure of Siberia or the Far East, they almost always are in the Russian military newspaper which still has the Soviet era title [?] and are efforts to terrify the civilian officials and the government to giving the collapsing Russian military even more money.

Fourth, the Russians can see themselves as a European power, at least most of the time, and the Chinese don't. They know they're not, and the Russians are very, very frightened about any suggestion that they are not part of the concert of Europe. That is a fundamental thing which limits Russia's freedom of action in much of the world and in dealing with the Chinese in particular, because the Russians do not wish to provide any more ammunition to those who say the border of Europe ends at Narva, as most of us in Estonia do.

Fifth, and this is perhaps the most important thing of all, neither of these countries has much experience with or is prepared to cooperate with someone else for very long on a condition of equality

or on a condition of subordination. Each of them would like to deal with the other as a subordinate, a junior partner. Neither now is willing to be a junior partner to the other for obvious reasons.

Now, what does all this mean for American policy? I think three things, at least. First, we need to be very clear, as we have not been, that the Russian Federation is a declining power and China is a rising one.

We do not organize our government commitment of resources that way or our diplomatic attention. All you have to do is look at the list of people who have senior positions on the fifth, sixth and seventh floors of the State Department. We are paying still far too much attention to Russia and far too little to China and that's one of the reasons why what you're doing is so important.

Second, we need to remember that these two countries sometimes are going to cooperate and sometimes to be in conflict with one another regardless of what we do. Whether these two are at loggerheads or they are in agreement will be largely independent of what we do, and therefore we have to craft our policies with the full recognition of that reality rather than assuming that nothing will happen in the world unless we make it so.

Third, and this is something that people are extraordinarily reluctant to admit, the world now is far more dangerous and will require far more resources to counter the very different kinds of threats that come from the rising power of China that other speakers have detailed and to deal with the declining power of the Russian Federation because countries that are newly weak as Russia is present problems to the world that are fundamentally different than the kind of the newly strong.

Because those are so different, they will require more resources, not less. There will be no peace dividend from the end of the Cold War. The costs will go up and that is not something we want to do.

As I said at the outset, I'm convinced we would be making a huge mistake to assume that we should embrace one of these countries to contain the other, something many are currently advocating, or worse, that we should adopt some kind of dual containment. Rather, it seems to me, we have to remain engaged with both, but also be willing to oppose both clearly and with force on behalf of our national interests rather than trying to triangulate our national interests with those of two other countries that pose such different challenges.

Thank you.

[The statement follows:]

**Prepared Statement of Paul Goble
Professor, EuroCollege, University of Tartu, Estonia**

***Only Interests Are Permanent:
Russian-Chinese Relations as a Challenge to American Foreign Policy***

For the last half century, the U.S. approach toward Moscow and Beijing has been profoundly affected by the approach that each of these capitals has adopted toward the other. In the 1950s, for example, American officials debated whether the two communist giants were in fact at odds, a debate finally settled by the Damanskiy Island clashes at the end of the 1960s.

In the 1970s, the U.S. sought to play up China's differences with Moscow in order to contain a then still-expansionist USSR, a policy which represented an important

extension of and some would argue condition for success of our longstanding containment doctrine.

Now, given the continuing decline of the Russian Federation in the wake of the collapse of the Soviet Union and the concomitant and dramatic rise of China economically, politically and militarily, we are again forced to consider how we should craft our policies toward the two and especially toward the latter.

Consequently, I want to commend you Mr. Chairman and also the Members of this Congressional Caucus for holding hearings on this most fateful question and to thank you for giving me this opportunity to speak before you.

Because I fear that all of us are too often driven by shifting headlines in this and other areas—by positive ones like the Chinese decision to de-link its currency with the dollar or by negative ones like the role of Russia and China in using the Shanghai Cooperation Council to call for the closure of American bases in the countries of Central Asia—I would like to ask that we look beyond these headlines and thus will use my time today to look at some of the fundamental forces driving the relationship between Moscow and Beijing.

I want to begin with the now classical but often forgotten observation of some of the most capable diplomatists that countries do not have permanent friends or enemies, but they do have permanent interests. That goes for the Russian Federation. It goes for China. And it goes for us.

And I want to argue that the underlying interests of the Russian government and the underlying interests of the Chinese government will both push them together toward cooperation in certain areas and drive them apart in others, a situation which means that we must be prepared to navigate between them rather than concluding as we have sometimes sought to do in the past all that we should back one of these countries against the other once and for all.

In an effort to make a contribution to this process, I would like to outline for you what I see as the five most important elements driving Beijing and Moscow together and the five most important interests driving them apart and then suggest how the U.S. can best position itself to advance its interests.

Doing so as I hope to show today will require from us a more agile diplomacy and a more vigorous assertion of American power on behalf of our national interests than we have sometimes demonstrated in the past. But I believe that is a precondition of our success in a world almost certain to be far more challenging and dangerous in the future than it has been in the past.

Where Russian and Chinese Interests Converge ...

Moscow and Beijing have many common interests, but there are five that are clearly at the top of their respective lists.

First, each of them is interested in asserting its power against the United States, the Russian leadership because it finds itself in a position of decline and the Chinese because it believes itself to be headed toward the status of a super power. Consequently, the two will come together as they did earlier this month doing so helps them stand up to Washington.

Second, each of them is terrified of instability and is willing to use authoritarian measures at home and abroad to try to reign it in. At home, both face serious challenges from their own minority populations, the Russians in the northern Caucasus and the Chinese in Xinjiang. Indeed, they have a common interest in seeing themselves continue in at least their current borders, something that is not entirely likely over the course of the next decade or so. And abroad, they oppose any loosening of control especially in the Central Asian countries that could spread like wildfire into their own territories.

Third, each of them is concerned about the consequences of nuclear proliferation and the prospect that sooner or later terrorists will get their hands on and then use nuclear weaponry. They are thus going to work together and advocate a far harsher international regime to prevent that from happening.

Fourth, each of them is especially frightened by Islam—Moscow is already the largest Muslim city in Europe and the Russian Federation will have at least an ethnic Muslim majority by 2030, and Beijing has within its borders far more than 100 million Muslims. Consequently, they are both struggling to come up with strategies that contain Islam and the terrorism associated with parts of that faith without inflaming things further, something neither has been able to do so far but that both will work together to try to devise.

And fifth, each of them is interested in restricting the rise of new powers independent of themselves, the Russians are especially concerned about the European Union and the Chinese about India. They are in this sense then status quo powers even though in many respects each of them is challenging existing power relationships around the world.

... *Where Russian and Chinese Interests Diverge* ...

But in many ways, these common interests, which often are the focus of American concerns, are outweighed by a divergence in the positions of the two Eurasian giants.

First, the Russian Federation is a declining power while China is a rising power. For much of the 1990s, it could even be described as a failed state, as a country without an effective central government. President Putin is working to reverse that, but he has not yet completed what is invariably a difficult task. Beijing knows this and knows that it is going to be the dominant power in the region in the future. That makes cooperation difficult—neither party is willing to accept the junior partnership position that the other is prepared to offer—and almost certainly sets the stage for more conflicts.

Second, the two have clashing economic interests. Russia is an exporter of raw materials—petrochemicals now and water in the future—while China is an importer of the same and a producer of goods for export. Those conflicts are likely to intensify given the failures of the Russian economy beyond the natural resources sector and the growth of the Chinese economy almost everywhere but there. Everything we know about economics tells us that will lead to conflict of one kind or another.

Third, population densities on the Russian side of the Sino-Russian borders are now at levels not seen since the Neolithic period, while those on the Chinese side are large and growing. Some Russian nationalists see this as a threat, even projecting that China will move north militarily at some point. Such concerns are almost certainly overblown at least in the short term, but they inevitably feed Russian racism and Chinese resentment and make cooperation much more difficult.

Fourth, the Russians conceive of themselves as a European power most of the time, while the Chinese know they are not. That limits Moscow's freedom of action: if it becomes too cozy with Beijing, it will not be able to present itself as the European state most of its leaders believe it to be. But it also means that the Chinese look in different directions and with a different time horizon than do the Russians, considering Asia as China's natural sphere of influence and thinking in centuries rather than months and years as Europeans and Americans tend to do.

And fifth, perhaps most important of all, neither of them is used to cooperating for very long with anyone else. Both see themselves as leaders of independent civilizations, and they are not going to defer to another on a long-term basis if they can avoid it. That is something the foreign policy elites of these two countries have been very clear about even if we in the United States with our almost inevitably more short-term approach have generally ignored.

... *And What the U.S. Can and Must Do About It*

What does all this mean for American policy? Let me point to three lessons that I believe we need to focus on if we are to advance American national interests in dealing with China and with the Russian Federation.

First of all, we need to be clear about the most important reality out there: the Russian Federation is a declining power, and China is a rising one, something we occasionally say but that we have not made a centerpiece of our foreign policy strategy. Your Caucus has already made an important contribution to this necessary shift, and I for one am very pleased about that.

Second, we need to remember that these two countries sometimes are going to cooperate and sometimes are going to be opposed to one another *regardless of what we do*. That means we need to understand the Russia-China relationship and allow it to work for us rather than getting ourselves involved when we don't need to be or concluding that there is an emerging alliance that will survive for long enough to threaten us.

And third, we need to understand that we will have to commit more resources not fewer to counter the rising power of China and to deal with the declining power of the Russian Federation. Beijing already threatens our interests now and will do so even more in the future. But despite much media and diplomatic hype to the contrary, Moscow does as well and does so in ways that we have not been willing to pay attention to.

I am convinced as I said at the outset that we thus would be making a mistake either to assume that we need to embrace one of these countries to contain the other—something that may have brought short-term benefits in the past but that is unlikely to do so in the future—or worse that we should adopt some kind of “dual containment” of the two.

Instead, we need to be ready to remain engaged with but prepared also to oppose both, a difficult task but one that should not—indeed, must not—be beyond our capacity as a nation.

Again, thank you very much for asking me to participate today.

Cochair TEUFEL DREYER. Thank you very much, Mr. Goble. Our last but hardly least speaker is Mr. Herman Pirchner, who is the Founding President of the American Foreign Policy Council, which is headquartered here in Washington. The Council under his leadership has hosted visits to Washington by hundreds of foreign officials, and incredibly Mr. Pirchner has visited Russia more than 50 times since 1989 and visited China many times as well. He has published a monograph titled "The Russia-China Border: Today's Reality."

Mr. Pirchner, welcome.

**STATEMENT OF HERMAN PIRCHNER, JR.
FOUNDING PRESIDENT, AMERICAN FOREIGN POLICY COUNCIL**

Mr. PIRCHNER. Thank you. Distinguished Members of the Commission, it's a pleasure to appear before you today to discuss Russian-Chinese relations and their implications for the United States. Many of the opinions that you will hear from me today are based to no small degree upon my travels in Russia and China and discussions I've had with officials, both in the capitals, but also in provincial cities throughout both countries.

During the times of my travels, strategic cooperation between Russia and China has increased dramatically encompassing not only military sales, but joint military research and development, common diplomatic stances on an array of international issues as well as non-military trade.

What's important to remember that the preconditions for this cooperation, the precondition was the settlement of the border dispute. That settlement began in the final days of the Soviet Union and was completed with the last settlement on the remaining disputed islands last month.

The logic underpinning this settlement was compelling for both sides. Facing the potential of a future clash with the United States over Taiwan, China did not want the indefinite commitment of resources required to protect a hostile 2,200-mile border with Russia. Russia lacking the manpower, resources, and political will to station large numbers of troops along its border with China also needed a border settlement that would permit it to focus on its long and traumatic domestic evolution.

Success in settling this border question gradually morphed into developing trade and increased strategic cooperation. Both Russia and China have sought the creation of a multipolar world as a means of preventing America's global dominance. As a result, the two countries found benefit in blunting American initiatives by cooperating in areas as diverse as missile defense, Taiwan, Central Asia and space policy.

What is the future of this relationship? In the short term, I expect it will grow, especially if anti-democratic forces continue to be ascendant in Russia. But there are many areas that if you look closely, you have to think the relationship is not going to last. I agree with Paul Goble. It's going to go up and down.

Areas for competition between Russia and China include Central Asia where competition will occur over energy as well as political influence. If you look at the arms trade, that's not as durable as one would think either because with \$120 million of currency re-

serves now, Russia is not as hungry to sell as they were ten years ago and on the other side, China doesn't need it as much because they are developing their own indigenous capacity to produce weaponry.

But the economic considerations while potentially straining the relationship probably will not be fatal to it. But questions of military power and sovereignty in the broader areas pose far more dangerous problems.

Because of Russian military ascendance in the 19th century, Russia imposed borders on China in 1858 and 1860 taking what is now the Russian Far East and Eastern Siberia away from China. This settlement left rough enough edges that in 1969 renewed border tensions led to fighting on the border and the widely recognized specter of a war between the Soviet Union and China.

Today, the balance of power is again changing and at a dramatic rate. Economically and militarily China is ascendant compared to Russia. Many Russians understand that this trend may again heighten tensions on the border. The current generation of Chinese leaders may be happy with the border settlement, but it's feared that next generations of Chinese leaders will not be.

Tellingly, during his 2000 trip to the Russian Far East city of Blagoveschensk, Russian President Putin warned its residents that "if you do not take practical steps to advance the Far East soon, after a few decades the Russian population will be speaking Japanese, Chinese and Korean."

Earlier this month, the governor of Khabarovsk Krai, Viktor Ishayev, echoed this theme by noting, and I quote: "Relations between Russia and China could become rougher and tougher and may face political and economic confrontation in ten to 15 years due to Chinese expansion in Russia's Far East."

But for Ishayev, current cooperation still has its pluses. Quote: "Russia should see China as a strategic co-traveler in the concrete historical period of achieving political goals."

In other words, for the moment, Russia and China are useful to each other. The growing disparity in both economic and political power will also cause frictions among this generation of Russian and Chinese leaders. As former National Security Advisor, Zbigniew Brzezinski put it, quote, "Strategic partnership between Moscow and Beijing is no more than a slogan. In fact, Russia can only be a junior partner there and it would never agree to that."

These Russian fears are real, but they are fears for the future and not the present. As such, they are not now sufficient to break the steady movement towards greater Russian-Chinese cooperation. In addition to the reasons previously listed for this growing cooperation, I would like to close by giving one more.

Habits of empire die very slowly. Consider France, which has used force in Africa at least 38 times since 1960 to maintain influence in its former colonies. We should not be surprised then that Russia seeks to maintain dominant influence in Ukraine where it has substantial economic interest in addition to ethnic, linguistic, religious and historical ties.

Far more than any discomfort caused by American bases in Central Asia or American support of the new government in Georgia, the successful, and I might add correct American support, of a

Western leaning Ukrainian president over his Kremlin-backed opponent has had a profound effect in Moscow.

Ongoing cooperation in the war on terror and nuclear issues notwithstanding, a consequence of the most recent Ukraine election will be to increase Russian cooperation with China especially through efforts that are at least partially aimed at reducing American involvement in the territory of the former Soviet Union.

China for reasons stated by Dr. Ott in the previous panel will welcome this increased cooperation.

[The statement follows:]

**Prepared Statement of Herman Pirschner, Jr.
Founding President, American Foreign Policy Council**

“The State of Sino-Russian Relations”

Distinguished Members of the Commission:

It is a pleasure to appear before you today to discuss Chinese-Russian relations, and their implications for the United States.

In the past 15 years, I have traveled 55 times to Russia and a dozen times to China. During all of these trips I have had conversations with senior officials in the national capital, as well as in many provincial capitals, of Russia and China. In the past 15 years, through the American Foreign Policy Council (AFPC), I have also hosted the U.S. visits of hundreds of officials from those countries. This interaction, as much as my research, forms the basis for the opinions I give today.

All of us have watched strategic cooperation between Russia and China increase dramatically—growing to encompass military sales, joint military research and development, common diplomatic stances on an array of international issues, as well as non-military trade.

The precondition for this interaction was the progressive settlement of the long-standing Russian-Chinese border dispute. The bulk of the current border delineation, largely agreed to in the closing days of the Soviet Union, was formally settled on July 16, 2001. However, agreement on the last disputed parts of the border was not formalized until June 2nd of this year.

The logic underpinning the settlement was compelling for both sides. Facing a potential future clash with the United States over Taiwan, China did not want the indefinite commitment of military resources required to protect a hostile 2,264-mile border with Russia. Russia, lacking the manpower, resources, and political will to station large numbers of troops along its border with China, also needed a border settlement that would permit it to focus on its long and traumatic domestic evolution.

The border settlement was also a prerequisite for bilateral trade. Russia was the only country able and willing to supply China with the sophisticated military equipment it coveted. Further, Russian sales of non-military items—such as lumber, ores and petroleum—were seen as central to the expansion of China’s economic and industrial activities. The border settlement also helped create the political environment necessary for Russian scientists and engineers to aid the development of Chinese military production.

Success in settling the border question and developing trade gradually evolved into strategic cooperation. Both Russia and China have sought the creation of a “multipolar world” as a means to prevent America’s unfettered global dominance. As a result, the two countries found benefit in blunting American initiatives by cooperating in areas as diverse as missile defense, Taiwan, Central Asia, and space policy.

These factors have formed the basis for a multi-faceted strategic partnership—one that, positive aspects of Russian-American and Chinese-American relations aside, has emerged as an unmistakable challenge to American interests in Eurasia and the Asia-Pacific.

Arms Sales

As recently as the 1980s, Moscow’s military sales to Beijing were negligible. Today, China is Russia’s top arms client, currently accounting for 45 percent or more of Russia’s total arms sales.¹ Since the collapse of the USSR, China has pur-

¹“Russian Arms Export Agency Seeks Latin American, Southeast Asian Markets,” *MosNews*, June 15, 2005, <http://www.mosnews.com/money/2005/06/15/armsexport.shtml>.

chased billions of dollars worth of fighter jets, missiles, submarines and destroyers from Russia. In the process, it has become the principal customer and lifeline for Russia's struggling defense industries.

During the tenure of Boris Yeltsin, the Kremlin made military sales to China a principal element of its defense export policy. Depending upon the estimates, Russia averaged between one and two billion dollars of annual military sales to China between 1992 and 1999.

These sales expanded with the ascension of Vladimir Putin to the Russian Presidency. At their July 2000 summit in Beijing, Putin and then-Chinese President Jiang Zemin signed a new strategic accord declaring a mutual commitment to "military-related technology cooperation" as part of joint efforts toward "expanding and deepening the Sino-Russian strategic cooperation partnership."²

There is little doubt that this partnership is lucrative for Russia's military industrial complex. But China benefits from this partnership even more through the acquisition of high-tech Russian weaponry such as *Sovremenny*-class naval destroyers and *Kilo*-class submarines. Over the past three years, these sales have greatly assisted the PRC's massive, multi-year military modernization, and aided the expansion of Chinese air, naval, land and asymmetric warfare capabilities. Russia, as one respected analyst has put it, has very much become China's "logistics base."³

Regional Alliances

Russia and China are also working to counter American influence through their involvement in regional alliances, primarily on the territory of the former Soviet Union.

The principal vehicle for this cooperation is the Shanghai Cooperation Organization, or SCO. The SCO is an outgrowth of the Shanghai Five, an organization created in 1996 that encompassed Russia, China, Kazakhstan, Kyrgyzstan and Tajikistan. The mandate of the Shanghai Five was simple: to strengthen security along the borders of its member states.⁴ In June of 2001, however, both the membership and vision of the Shanghai Five was expanded, incorporating one additional country—Uzbekistan—and broadening the group's mandate to include strengthened cooperation in the fight against "terrorism, separatism and extremism," as well as greater interaction in the spheres of economy, culture, education, and tourism.⁵

This cooperation has entailed the establishment of a "Regional Anti-Terrorist Structure," or RATS, in the Uzbek capital of Tashkent, and growing collaboration on regional security with other security structures in the "post-Soviet space"—most directly, the rapid deployment forces of the Collective Security Treaty Organization (CSTO) headquartered in Kyrgyzstan. The organization has also developed a unified policy on Afghanistan, establishing an Afghan-SCO contact group last fall and maintaining ongoing contacts with the government of Hamid Karzai in Kabul.⁶ While the organization currently does not possess an anti-terrorism force of its own, some members are lobbying for the creation of "strong collective rapid-deployment forces to counter international terrorism and religious extremism."⁷

An unstated goal of the SCO, however, is to check U.S. influence, particularly in Central Asia, where the U.S. is now deeply involved as a result of the Global War on Terror. This has become increasingly clear in recent weeks, as Moscow and Beijing have expressed growing concern over the potential for additional "color revolutions" in the Near Abroad, and have successfully lobbied the Central Asian members of the SCO to formally call for a withdrawal of U.S. forces from the region.⁸ At the same time both Russian and Chinese papers have discussed the opening of a Chinese military base in Kyrgyzstan.

The SCO, in short, is increasingly becoming a venue through which both China and Russia can work to counter American interests. Moreover, the organization is actively expanding its geographic base, and its geopolitical leverage. At the SCO's

²As cited in Constantine C. Menges, *China: The Gathering Threat* (Nashville: Nelson Current, 2005), 353.

³John J. Dziak, *The Military Relationship Between China and Russia, 1995–2002* (Washington: American Foreign Policy Council, August 2002), 5.

⁴Embassy of the Republic of Kazakhstan to the U.S.A. and Canada, "Special Edition: Astana Summit Brings New Horizons for SCO," *Kazakhstan News Bulletin*, July 7, 2005, <http://www.kazakhembus.com/070705.html>.

⁵Ibid.

⁶See, for example, Sergei Blagov, "Shanghai Group Aims to Keep U.S. in Check," *Asia Times* (Hong Kong), June 19, 2004, http://www.atimes.com/atimes/Central_Asia/FF19Ag01.html.

⁷"Tajik President Calls for SCO Rapid-Reaction Force . . ." *Radio Free Europe/Radio Liberty Newswire* 9, no. 121 (2005), <http://www.rferl.org/newswire/2005/06/2-TCA/tca-270605.asp>.

⁸Simon Ostrovsky, "Kyrgyz, Uzbek Bases Targeted," *Agence France Presse*, July 6, 2005.

most recent summit, held in early July in Astana, the bloc formally voted to extend observer status to three nations—India, Pakistan and Iran.⁹

Fault Lines

What is the future of this relationship? In the short term it may grow—especially if anti-democratic forces continue to be ascendant in Russia. But there are many reasons to believe that Russian-Chinese cooperation may lack durability.

Self-sufficiency

When discussing the current Russian-Chinese arms trade, it is useful to remember that this sort of commerce was never intended to be an end-state, at least by China. The public insights that we have into Chinese military espionage activities, and into their defense development efforts, suggest strongly that they are not simply trying to acquire foreign hardware and associated know-how. The ultimate goal is to enable the PRC to reverse-engineer Western weapons systems as part of a long-term plan for military self-sufficiency.¹⁰ To that end, the Pentagon's most recent report on China notes that the PRC has commenced a major indigenous effort aimed at "reorganizing (its) defense industry, modernizing industrial facilities, and acquiring foreign technology to develop and produce advanced weapons systems to support PLA modernization."¹¹

Among other factors contributing to this decision, China knows that it cannot bank upon Russian dependence. In fact, hard currency reserves in Russia have grown dramatically in recent years, overwhelmingly due to Russia's expanding energy sales, and now stand at some \$120 billion or more.¹² Officials in Beijing, therefore, cannot assume that Russia will indefinitely remain an arms supplier based solely on the need for Chinese money, and they are making other plans. Additionally, Russia's brief turn toward the U.S. post-September 11th, and the muted tenor of Beijing-Moscow dialogue during that period, has made it clear to PRC officials that improved U.S.-Russian relations are likely to come at the expense of the Sino-Russian relationship.

Energy

As part of the Treaty of Good-neighborliness signed by Presidents Putin and Jiang in 2001, Moscow and Beijing agreed to a substantial expansion of energy contacts. Yet, some four years later, that cooperation has failed to materialize in any substantive way. The slow pace of this facet of the Sino-Russian relationship provides a telling indicator of Russian concerns regarding the potential dangers of aligning too closely with China.

Nowhere is this hesitance clearer than in the case of the "Angarsk-Daqing" pipeline. Plans for that energy route were laid in 2001, and entailed collaboration between Russia's Yukos oil conglomerate and China's state CNPC on the construction of a 2,200-kilometer pipeline linking the Siberian city of Angarsk to Daqing in China's northeastern province of Heilongjiang. The pipeline was originally expected to go online this year, and to provide China with 20–30 million tons of oil annually.¹³ But in 2004, Russia aborted plans for the pipeline in favor of a more lucrative energy route to Japan and other Asian markets through the Russian Far East. The message was clear: the Kremlin had little interest in having China as the only customer for oil carried through the pipeline.

Another area of potential conflict lies in Central Asia. Over the past two years, China has made major energy inroads into Russia's Near Abroad. In 2003, Chinese President Hu Jintao visited Kazakhstan and signed a landmark accord for a pipeline to bring Kazakh oil to China.¹⁴ That pipeline, dubbed "Atasu-Alashankou," is slated to come online by year's end, and will initially carry ten million tons of oil annually from the Caspian coast to Xinjiang. It is expected to eventually become one of Kazakhstan's primary export routes, and by 2015, it could pump as much as 3.5

⁹Daniel Kimmage, "SCO: Shoring Up the Post-Soviet Status Quo," *eurasianet.org*, July 9, 2005, <http://www.eurasianet.org/departments/insight/articles/pp070905.shtml>.

¹⁰Dziak, *The Military Relationship Between China and Russia, 1995–2002*, 3.

¹¹United States Department of Defense, Office of the Secretary of Defense, *Annual Report to Congress: The Military Power of the People's Republic of China 2005*, July 19, 2005, <http://www.defenselink.mil/news/Jul2005/d20050719china.pdf>.

¹²"Standard & Poor's Upgrades Russia's Sovereign Debt Rating to Investment Grade," Associated Press, January 31, 2005.

¹³Sergei Blagov, "Russia Walks Thin Line Between Japan and China," *Asia Times* (Hong Kong), July 15, 2005, http://www.atimes.com/atimes/Central_Asia/GA05Ag01.html.

¹⁴John C.K. Daly, "Kazakhstan Inks Oil Pipeline Agreement with China," Jamestown Foundation *Eurasia Daily Monitor*, May 19, 2004. http://www.jamestown.org/publications_details.php?volume_id=401&issue_id=2957&article_id=236726.

million barrels of crude daily to China.¹⁵ Very significantly, if the pipeline is used to its maximum capacity, China will tie up upwards of ninety percent of Kazakhstan's projected oil output, effectively taking Kazakhstan "off the table" as an energy supplier to pro-Western energy routes such as the Baku-Tbilisi-Ceyhan (BTC) pipeline.

Smaller scale projects for natural gas exploitation are also underway in Turkmenistan.¹⁶ Most recently, in the wake of unrest in Uzbekistan this spring, Beijing has emerged as a major benefactor for the regime of Islam Karimov. After his government's clampdown on domestic unrest, Karimov traveled to China, where he was warmly received by Chinese President Hu Jintao and other top PRC officials, who expressed their solidarity with Tashkent's recent policy decisions. In return, the Uzbek leader has reportedly approved a \$600 million joint-venture oil deal between Uzbekneftegaz, the Uzbek state energy company, and China's state-owned China National Petroleum Corporation to exploit 23 oilfields in the Central Asian republic.¹⁷

This successful drive into Central Asia promises to eventually make China a serious contender for regional influence, and diminish Russian standing in the region. Additionally, Russia could soon face a challenge closer to home, since Russia's energy sector is a logical target for expanding Chinese energy demand. It is not beyond the realm of possibility that Russia may someday soon be confronted with the same sort of buy-in bid from China that the United States is facing over Unocal.

While straining the strategic relationship, these economic questions should not be fatal to it. The question of the balance of military power and sovereignty over the border areas, however, is far more serious.

Privately, if not publicly, many Chinese continue to consider large portions of Russia's Far East to be Chinese property. Russian officials, particularly in the regions bordering China, are painfully aware of this fact, and are nervous about Chinese intentions regarding their land. To fully understand this problem, a quick historical view of the border is necessary.

In 1689, after decades of conflict between Russian and Chinese traders and soldiers in the largely empty space of today's eastern Siberia, a stronger China imposed the Treaty of Nerchinsk on Russia. This treaty gave China sovereignty over much of Eastern Siberia and the southern part of today's Russian Far East. Treaties in 1858 and 1860, reflecting a weakened China and a resurgent Russia, gave that territory back to Russia. In 1969, the border question was reopened as renewed tensions led to fighting, some casualties, and the widely recognized specter of war between the Soviet Union and China. Today, the balance of power is again changing, and doing so at a dramatic pace. Economically and militarily, China is ascendant relative to Russia and many Russian strategists understand that eventually this trend may again heighten tensions along a border whose Chinese side is at least 25 times more densely populated than the Russian side. If larger areas are considered, the demographic problem is no better for Russia. Less than 16 million people live in Eastern Siberia and Russia's Far East. By contrast, over 1.3 billion people live in China. The current generation of China's leaders is happy with the border settlement, but many in Russia fear that the next generation of Chinese leaders will not feel the same.

Not surprisingly, strategic thinkers in Russia have come to worry about the potential for Chinese infiltration, either directly or through gradual re-settlement policies that may be undertaken by Beijing. Tellingly, during his year 2000 trip to the Far Eastern city of Blagoveschensk, Russian President Vladimir Putin warned its residents that, "if you do not take practical steps to advance the Far East soon, after a few decades the Russian population will be speaking Japanese, Chinese and Korean."¹⁸

Earlier this month, the Governor of Khabarovsk Krai, Viktor Ishayev, echoed this theme by noting that "relations between Russia and China could become rougher and tougher and may face political and economic confrontation in 10–15 years due to Chinese expansion in Russia's Far East."¹⁹ But for Ishayev, current cooperation still has its pluses: "Russia should see China as a strategic co-traveler in the con-

¹⁵ "China-Energy-Kazakhstan-Pipeline," Interfax (Moscow), July 14, 2005.

¹⁶ John C.K. Daly, "The Dragon's Drive for Caspian Oil," Jamestown Foundation *China Brief* 4, iss. 8 (2004), http://www.jamestown.org/news_details.php?news_id=48.

¹⁷ See, for example, Andrew Yeh, "Uzbekistan Signs Dollars 600m Oil Deal with China," *Financial Times* (London), May 26, 2005.

¹⁸ John Daniczewski, "China, Russia Pledge Friendship," *Los Angeles Times*, July 17, 2001.

¹⁹ As cited in "Sino-Russian relations may worsen in a decade": official," *Press Trust of India*, July 5, 2005.

crete historical period of achieving political goals." In other words, for the moment Russia and China are useful to each other.

The growing disparity in both economic and military power will also cause frictions among this generation of Russian and Chinese leaders. As former National Security Advisor Zbigniew Brzezinski put it, "strategic partnership between Moscow and Beijing is no more than a slogan. In fact, Russia can only be a junior partner there, and it would never agree to that."²⁰

These Russian fears are real, but they are fears for the future, not the present. As such, they are not now sufficient to break the steady movement towards greater Russian-Chinese cooperation. In addition to the reasons previously listed for this growing cooperation, I would like to close by giving one more.

Habits of empire die slowly. Consider France, which, to maintain influence in its former colonies, has used military power in Africa at least 38 times since 1960. We should not be fully surprised then, that Russia seeks to maintain dominant influence in Ukraine where it has substantial economic interests in addition to ethnic, linguistic, religious, and historical ties. Far more than any discomfort caused by American bases in Central Asia, or American support of the new government in Georgia, the successful and correct American support in the election of a Western-leaning Ukrainian President over his Kremlin backed-opponent has had a profound effect in Moscow. Ongoing cooperation in the War on Terror and nuclear issues notwithstanding, a consequence of the most recent Ukraine election will be to increase Russian cooperation with China—especially through efforts that are, at least partially, aimed at reducing American involvement in the territory of the former Soviet Union.

Panel VIII: Discussion, Questions and Answers

Cochair TEUFEL DREYER. Thank you very much, Mr. Pirchner. We have 25 minutes so Commissioners I know you have lots of questions, but try to be economical about this, because we have a business meeting at one o'clock.

Okay. Our first questioner is Commissioner Donnelly.

Commissioner DONNELLY. Gosh, twice in a row, what a thrill. Three quick questions for everybody, but I'll ask you to sort or resist the temptation to everybody answer every question so there ought to be enough for everybody to say something.

First of all, how do we anticipate China will react to the visit of Prime Minister Singh and the nuclear deal that's come out of it? And the prospect of a deepening strategic partnership between the United States and India?

Second, whether the Shanghai Cooperation Organization seemed pretty moribund 18 months ago or something like that, and in particular its support for the Uzbeks is troubling and just, so whether the SCO?

And finally, just because I'm fishing for Unocal tidbits, Unocal has some serious holdings in Azerbaijan, which is a place, probably the only reliable partner that the United States has in the Caspian at this point, so if Unocal's holdings become Chinese holdings, how does that affect both the American energy position in the Caspian and the American political position in the Caspian? And there is three minutes and 47 seconds left. Go.

Dr. GARVER. On the Shanghai Cooperation Organization, I think from the Chinese standpoint, that organization is very important. They view it as one of their prime ventures in high diplomacy over the last decade. This is one of the few international organizations in which China plays a leadership and high profile role. So it's important for prestige reasons.

²⁰As cited in Colin McMahon, "Russia, China to Sign Friendship Accord," *Chicago Tribune*, March 7, 2001.

The SCO is also important because it institutionalizes the strategic partnership, the strategic partnership with Russia. The SCO's original and still primary function was to counter the Islamic radicalism which came to Central Asia with the end of the Soviet Union, and to maintain stability in what China views as its strategic backyard. But Sino-American relations deteriorated in the 1990s, they increasingly took on an anti-U.S. purpose—keeping the United States out of China's Central Asia backyard.

Since 9/11 China has tolerated, but been very concerned with the growing U.S. military presence in Central Asia, and I think they see the Shanghai Cooperation Organization as a way of limiting that presence, and ultimately rallying regional support to get the Americans out. From the Chinese standpoint, the SCO is a major element of their diplomatic strategy.

Mr. NALAPAT. I would just like to confine myself to this nuclear cooperation agreement with the United States. I think China would be looking upon it very negatively because they have regarded the nuclear issue as the big block against Indian and U.S. scientific, technological and military cooperation.

Now, this roadblock seems to be getting cleared away, and that will be alarming them. Our problem is that in India, we see that the NPT and all these structures that have been created have one big problem in them, and that is that the Big Five are almost in effect exempt from any of its provisions. They can do what they like.

Any of the Big five can do what they like and the Chinese have been doing pretty much what they like. So I would think that their reaction is going to be extremely negative because of the fear that this will lead to a much broader engagement of India.

Mr. GOBLE. With respect to the Shanghai Cooperation Organization, I would just reinforce what's been said about the continuing vitality of imperial perspectives. The recent statement of the Shanghai Cooperation Accord against American bases in Uzbekistan must be seen as a direct follow-on to the fact that when Uzbekistan, a sovereign independent country agreed to have an American base there, the President of the United States thanked the President of the Russian Federation for that reality. So it is not simply a move against us. We are participants unfortunately.

With respect to Unocal and Azerbaijan, I think the Azerbaijanis would actually welcome Chinese participation in their oil industry and here's why. It would make it far easier for them to expand their activities in Iran than would otherwise be the case.

To the extent that Azerbaijan's oil industry is viewed as completely linked into an American-centric model that limits their ability to explore south of the Arax River. So if there's a China east component and people like Haidar Aliyev's security advisor was trying to promote Chinese investment in Azerbaijani's oil system seven, eight years ago, then that helps them and I think they would welcome it.

It will make it somewhat more difficult for the United States because it will open the door south from Baku to Tehran in ways we'll find uncomfortable, I think.

Mr. PIRCHNER. I note only that the SCO statement asks not only for the removal of bases but for ceasing military over flights. Last-

ly, I would note that had there not been so much nervousness about the toppling of governments in Ukraine, in Georgia, in Kyrgyzstan, there's at least some doubt that this statement would have come out. People are worried about the U.S. presence. I'm not saying our policy is wrong. I think it's right, but the SCO statement is a consequence of this policy.

Cochair TEUFEL DREYER. Thank you. Commissioner Mulloy.

Commissioner MULLOY. This question is directed to Professor Nalapat, but if anyone else wanted to respond. In our previous panel, I believe it was Dr. Marvin Ott from the National Defense University, discussed China kind of as following a great power strategy in that they would, the regime there would treat our pushing for democracy in China as kind of a real threat because that doesn't seem to be—they don't have a long tradition of that in their history and that may not be the way they like to organize themselves.

Do you think it should be a strong element of American foreign policy to be pushing toward the democratization of China or should we be more practical in some way or other? Is that the right way to go or should we be picking specific issues and say we want to resolve these without pressing for the larger democratization of the country?

Mr. NALAPAT. Commissioner, my answer to that would be that you can have a strategy which is not based on complete avoidance and exclusion of all elements inside a country, but you can work with some elements and not work with the formal government of that place.

In Myanmar, for example, and in Iran, there's a U.S. policy of almost total avoidance which is now cutting away a lot of, if I may say so, democratizing and moderate and Western and other influence in these two countries.

We had a situation which we had that policy in Myanmar. We never had that policy in Iran, but it has to be remembered that India has never given Myanmar or Iran any military equipment or any strategic technology unlike China. So my belief is that as a democracy, you should engage with the people, form direct links people to people, agency to agency, and not have a policy of exclusion. So far as we are concerned, we are a much weaker country and therefore we have much stronger constraints. China is our next-door neighbor.

We have other problems, but you are a much bigger country and obviously a bigger country can afford to follow a policy which in my view is much more moral and ethical than we can be expected to follow because frankly being bigger is not the same as being strong enough.

Commissioner MULLOY. Does anybody else want to comment?

Dr. GARVER. Could I address that?

Commissioner MULLOY. Dr. Garver.

Dr. GARVER. Yes. I would urge us to be cautious in terms of anticipating the consequences of any efforts to change China's political system. First of all, I think it's very likely that [an attempt to democratize China] could have unintended consequences on Chinese politics, producing not more positive Chinese sentiments toward the United States, but more intense anti-U.S. sentiments.

U.S. pressure on China after Tiananmen, after 4 June 1989 was motivated largely by a desire for the Chinese people to enjoy freedom and democracy, which Americans felt all humans should enjoy. That was what the U.S. intended. But in fact, the result of U.S. actions within China, within the actual political milieu of China, was that the regime was able to use U.S. actions to foster the growth of virulent anti-American “new nationalism.” Sure the Chinese Communist Party manipulated and misinterpreted U.S. actions to accomplish this end. But the point is that U.S. moves inspired by high-minded purposes backfired and produced strong anti-American sentiment in China. I would argue that we should let China find its own way, and be aware that the consequences of our action [to democratize China] will not necessarily what we intended, but could well have unintended consequences.

Secondly, I would urge that if we treat the Chinese Communist-led government as a target of overthrow, as destined for the dust bin of history, we would in effect have said that that regime is an energy regime. Our chances therefore of being able to cooperate with that regime on important foreign policy issues such as Korea, Iran, Iraq and other issues, would be minimal. I would argue that our relation with China involves a mix of both competing and common interests. Where our interests conflict, our policies compete. But we also have important common interests on which we can, and do, cooperate—on Iraq’s invasion of Kuwait, Iran’s nuclear programs, on Korean issues. Such cooperation would be very difficult, probably impossible, if we targeted the Chinese Communist Party regime for overthrow.

Commissioner MULLOY. Mr. Goble, you wanted to comment?

Mr. GOBLE. Yes, I would just like to second the notion of worrying about the additional consequences of what we do. While it is the case that the America’s strong reaction to the Tiananmen massacre led to some very bad things emerging in China, it is almost certainly the case that our reaction against the killing of peaceful demonstrators in Beijing at that time tied the hands of those in Moscow who wanted to do the same thing to save the Soviet Union.

And that we know from what people have said since the end of the USSR, that people were afraid that if they engaged in large blood, which is how the Russians referred to it, that the West would cut them off and that probably opened the door to the dramatic changes in Eastern Europe and the Soviet Union.

So it is very complicated. I think your point is extremely well taken about how careful we have to do, and I would urge that when we look at any one of these policies, we ask where its consequences are rather than asking in a limited way will it do what we want in this one case because everything we do is on view and has impacts spreading throughout the world.

Cochair TEUFEL DREYER. Commissioner Becker.

Commissioner BECKER. Thank you very much. I have two questions. One is to Professor Nalapat. I’m going to refresh his memory first. I met you here in Washington, D.C. maybe a year ago, and I was rather taken by your description of the United States losing prestige and losing influence within the South China Sea, within the rim countries, including India. I hope you don’t mind, but one of the questions I asked you is if there was a conflict with Taiwan,

where would India come down? At that time you said, “well, don’t be surprised if they came down on China’s side.” I’d like you to give us a little bit on that.

But let me lay the other question out in case we have time with the two Soviet-Sino experts. I’m not saying that facetiously. A lot of people have written and said that the next war is going to be fought over resources and they point to China and they point to Russia. And the thing that will lead to that is a lack of resources in China and the abundance of resources straight north and a lack of Soviet population along the border.

China constantly keeps in the background that that border is not correct. I don’t know if they’re going back to Genghis Khan or what, or the Silk Road from Cathay, and I would like your feeling on that point.

Also, the way we dealt with Russia, right or wrong, was through containment. And very strict isolation, deprive them of resources and let the country itself beggar itself down to where it collapsed from within. I’m not saying that’s the proper way to do things, but that’s the way we did it. It was successful. The Communist regime fell as did the Soviet bloc countries in Eastern Europe.

Then, on the other hand, we turn around right away and we go with China with the policy of engagement. Is that right or wrong? Simply, are we on the right policy? We were on the wrong policy before? What are we doing? Professor Nalapat.

Mr. NALAPAT. So far as Taiwan is concerned, the reality is that you will find about six or 7,000 Indian scientific and technical personnel now working in Taipei and we hope this will go to around 30 to 40,000 in the next eight or nine years. The reality is that I think that several people in Taiwan realize that sourcing their R&D in China is going to be a big problem for them in the event of conflict.

And they are now looking at India as an alternative to sourcing their R&D, so there is vigorous scientific cooperation.

Again, so far as a Taiwan is concerned, totally outside government, we have informally told the Taiwanese to give us a stake. As of now, there is almost no trade between India and Taiwan. There is a huge trade developing between East Asia and India, Southeast Asia and India, which is where our Navy is coming right up to Japan, because we believe that we have an interest and a stake in this region.

So as Taiwan ties expand, definitely we’ll be getting a stake in the region, and as we get a stake, I think we are going to protect our interests in a much more vigorous fashion.

Mr. GOBLE. With respect to your two questions directed at us, I certainly believe that in the 21st century, we will see many, many conflicts and wars over resources. I think they are more likely to be about water than they will be about petrochemicals. And I think that our failure to worry about hydrology is a huge one. Take a look at what the relationship between Turkey and Israel, for example, which is based on access to water as an exemplar of where things are going.

With respect to resources straight north, there are lots of ways to get those resources. One of the problems is it’s very tough to do so because this is an area where there is not much infrastructure.

Mr. Putin got all kinds of credit from the West about his glorious trans-Russia highway, which was completed, but it's been in construction since 1903. Most of it isn't paved and only five percent of it is only two lanes wide. Consequently, Russia has had enormous difficulty developing the oil and gas fields in Eastern Siberia and China would too.

There are lots of ways to get at that without conquest. So conquest may happen. There are people who think the borders are different. I live in a country where everybody has a map of Estonia that shows borders that no one else in the world accepts. And they're not going to change.

I think the border between the Russian Federation and China, the agreement was signed because the Russian government desperately wants to have border agreements with everybody and has pushed very hard all the way around because it wants to be on record since it's afraid of losing some of that.

That's one thing. With respect to containment, the policy of containment was never exclusively about just blocking them off. It was also about using information, the radios, other kinds of cultural exchanges, pushing our ideas. But it was a different world that was created for. The level of economic interconnectedness in 1948 when we are launching our containment policy was, we're talking about American trade exposure percent of GDP. Now we're talking about you know an order of magnitude larger than that, consequently our ability to do that is much less if we're going to be really serious.

I doubt we're prepared to do that. I think containment was a brilliant policy as originally articulated. That is to say George Kennan's article early on. I'm not sure it was always implemented very well, and I doubt very much that we could achieve our ends with China that way. I think it's more likely that that would generate the kind of Chinese nationalism and regional assertiveness that we would find it very, very difficult to sustain for very long and that we would find it that the Chinese would exploit.

I would urge not thinking about containment. I think we have to be much more prepared to a much more forward policy than that rather than a much more limited policy.

Commissioner BECKER. I was not suggesting that we change anything. I was asking whether or not you felt we made a mistake.

Mr. GOBLE. No, I think we did the right thing with respect to the Soviet Union, the world as it existed at that time. I don't think we could do it again as the world exists now given economic interconnectedness, and I think there's a fundamental difference between China given its enormous population and the overseas Chinese and our ability and the Soviet Union which was a fragile empire to begin with.

Cochair TEUFEL DREYER. Mr. Pirchner, you have the last word on that one.

Mr. PIRCHNER. A couple of comments. First a comment on the history. The contested border areas were largely occupied by primitive tribes in the 17th century. As Russian and Chinese traders came in to these areas, they began fighting. China was stronger at the time. They whipped the Russians, who took the territory back in 1858 and 1860. The Russians took it back. The fear is now that the Chinese will have retribution as they become stronger.

And it's not necessarily a military thing.

The population density on the Chinese side of the Amur is probably 40 times the density that's on the Russian side, and I've traveled that entire border. I spent six weeks on it. You have less than ten million, maybe less than 8 million people in the Russian Far East, maybe less than 17 million in all of Eastern Siberia, contrasted with China's huge population.

You have Chinese immigration there. If you have a breakdown of order in Russia and you get five, ten million Chinese in that area, is it China or is it Russia? Even now China exercises a great deal of influence there because they're the economic engine and many Russian officials make their money under the table and otherwise through Chinese trade.

On resources, I agree with Paul. They are more likely to be bought than conquered. The big issue is if there will be vertical economic integration within Russia to stabilize the population. Right now Russia sells just raw materials to China, raw timber as opposed to processed wood, sells metals as opposed to casting ingots and so forth. To the extent that Russia is able to get the capital to vertically integrate their industries, they'll do better.

On containment, yes, I think it was right if you forget about the previous mistakes made at Yalta and Potsdam.

Cochair TEUFEL DREYER. Thank you. Our time is up. I want to thank our panelists profoundly and also thanks to someone who was not able to testify, Matthew Oresman, who is the Director of the China-Eurasia Forum, who has very kindly submitted testimony for our record. So thank all five of you very much.

[Whereupon, at 1:00 p.m., the hearing was adjourned.]

**Statement of Matthew Oresman
Director, China-Eurasia Forum**

***China's Emergence in Central Asia and the
Implication for U.S. Foreign Policy***

Overview^{1,2}

China's engagement in Central Asia has been one of the more intriguing developments of the past decade. China's interest in building relations with Central Asia has a long history dating back to the foundations of the "Silk Road," but the agility and creativity China has exercised in orchestrating its "re"-emergence in recent years has taken many by surprise, especially given the newfound importance of the region to the United States and Russia following September 11, 2001. China has moved rapidly from the difficult task of delineating and disarming its borders with Russia, Kazakhstan, Kyrgyzstan, and Tajikistan, to building a multilateral organization and economic and security ties, all while working to alleviate traditional suspicions among Central Asian states about Beijing's intentions. This testimony will detail these developments and the Chinese interests that drive them, and while these developments have an obvious bilateral component, the primary focus of this testimony will be on China's approach to the region as a whole.

Today, China has four principal sets of interests and policies in Central Asia that define its actions there. First, China has strategic and diplomatic goals in Central Asia that play into China's overall foreign policy, particularly as a component of China's "new security concept" and a showpiece of the softer side of China's foreign policy. Second, China has pressing domestic security interests focused on cutting off external support for Xinjiang separatists. Third is the continued stability and security of the negotiated borders that developed after the fall of the Soviet Union. Lastly are China's economic and trade interests in the region, especially the development of energy resources, are increasingly important.

The prominence of China in Central Asia will grow over the next decade, particularly if the Russian position wanes and the strategic attention of the United States is drawn elsewhere. On the basis of geography and economic realities alone, China appears well placed to expand its influence in the region over the long run. Central Asian states will continue to seek robust engagement with China as their transportation infrastructure and developing economies become increasingly intertwined. China likely will continue to exercise a light touch with its diplomacy to assure stable, productive relations along its interior frontiers, while dispelling fears that it is seeking regional hegemony.

However, China's current regional position does not yet come close to matching that of the United States or Russia in any measurable terms. The United States and Russia provide development assistance, financial aid, and equipment gifts in the billions of dollars. Moreover, both can ably assist the Central Asians in practical responses to terrorist attacks, something China cannot yet do. There are signs that this situation is beginning to shift, however, as China continues to increase its assistance to Central Asia, and the United States attenuates its assistance to some states, particularly Uzbekistan, due to continued human rights violations there.

The United States and China share similar goals in Central Asia, particularly with regard to combating terrorist activity emanating from the region. Beijing recognizes at present that the United States can serve China's interests in Central Asia. However, looking ahead, Washington, Moscow, and Beijing could find themselves competing for influence in this region, as their regional priorities move beyond immediate security concerns to encompass such fundamental questions as Great Power influence, political change, and the direction of energy exports. Moreover, China maintains a long-standing concern with "strategic encirclement" by the United States, and Washington remains wary of China's long-term rise and its implications for U.S. interests. All of these calculations figure into the crafting of China's Central Asian policy and regional engagement plans.

¹Matthew Oresman is the Director of the China-Eurasia Forum (www.chinaeurasia.org). This testimony reflects his personal views and not those of any organization with which he is affiliated.

²For a more complete description of China's emergence in Central Asia, see *China's New Journey to the West: Report on China's Emergence in Central Asia and Implications for U.S. Interests*, CSIS Press, August 2003; and "Beyond the Battle of Talas: China's Re-emergence in Central Asia," in *In the Tracks of Tamerlane*, National Defense University Press, August 2004; from which much of this testimony was drawn.

China's Interests and Policies in Central Asia

Strategic Positioning

In its relations with Central Asia, China seeks to attain several key strategic objectives. First, at the broadest level, China's approach to Central Asia helps promote its overall diplomatic strategy of establishing a more peaceful and constructive external environment, while fostering an image of China as a responsible power. The Shanghai Cooperation Organization (SCO), made up of China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan, is a concrete manifestation of this overall foreign policy effort, giving substance to China's widely-touted "new security concept" and its emphasis on the "Five Principles of Peaceful Coexistence."³ It provides Beijing an opportunity to demonstrate the value of a multilateral, consultative process versus unilateral or alliance-based approaches to regional security. The SCO provides a prominent platform from which Beijing can comment, and in some cases act, on the "three evils" of terrorism, separatism, and extremism. Moreover, in establishing and shaping the agenda for the SCO, Beijing has sought to demonstrate its good faith leadership on regional issues of mutual interest.

The Shanghai Cooperation Organization is a Chinese-initiated international organization that evolved from the border demarcation and demilitarization process, then known as the "Shanghai Five" (which did not include Uzbekistan), that began after the collapse of the Soviet Union. The SCO became a "full fledged" international organization in 2004 with the launch of a secretariat in Beijing and a regional counterterrorism center in Tashkent. As will be seen, the SCO plays an integral role in all aspects of China's engagement with Central Asia.

Second, China's relations with Central Asia help Beijing to establish stability on its closest periphery, so it can focus on pressing domestic and external challenges elsewhere. By and large, Beijing's approach to the region has succeeded in establishing productive political and economic ties that are likely to endure over time. From the perspective of the Central Asian states, their engagement with China represents, on one hand, a potentially huge boon for both the economic development and security situation of the region. On the other hand, the Central Asian elites are still worried that China has not shown its true intentions for the region. If China is seeking regional hegemony or dominion, it is still an open question for many governments; and they approach Chinese beneficence with caution. Still, these nations, particularly Kyrgyzstan and Tajikistan, are sustained by international assistance and support and cannot afford to turn away China, especially if Beijing's intentions are not nefarious. Thus, the Central Asian states, while viewing China with prudence, also see the vast opportunity in bringing yet another outside patron into the region.

Third, China's policies in Central Asia assist Beijing in managing its bilateral relationships with the other two major powers in the region, Russia and the United States. China seeks to use common interests in Central Asia to strengthen its relationship with Russia, the traditional "big brother" to the region, and foster a strategic environment that matches their respective worldviews. The Shanghai Cooperation Organization represents both the cooperative and competitive nature of the Sino-Russian relationship. The advent of the SCO in 2001 demonstrated Russia's reluctant self-understanding that it could no longer single-handedly maintain Central Asian stability and that China had an emerging role to play in the region that it could not block. Thus, while the SCO supports shared Chinese and Russian interests, it also acts as a Russian mechanism to monitor and restrain Chinese encroachment into its traditional "backyard." Conversely, the SCO may give China the opportunity to provide a potential alternative to the Russian-dominated Collective Security Treaty Organization (CSTO), which serves as the new collective defense arm for several of the Central Asian states.

China also carries out its policies in Central Asia with an eye on the United States. Beijing's concerns over a growing U.S. presence in Central Asia, which now includes a military presence in Kyrgyzstan and Uzbekistan, underscore its longer-term interests in establishing stronger ties with its Central Asian neighbors to counter a potentially antagonistic U.S. presence on China's western doorstep. This concern is directly linked to China's historic fear of "strategic encirclement," particularly that the United States will have the capability to launch attacks on China or exert influence against China from all directions along its periphery. This has been

³China's "New Security Concept" is an evolving foreign policy framework aimed at fostering a more equitable, multipolar, and "democratic" international political and economic dynamic worldwide based on the Five Principles of Peaceful Cooperation: mutual respect for sovereignty and territorial integrity; mutual nonaggression; mutual noninterference in their respective domestic affairs; mutual benefit; and peaceful coexistence.

reflected in various SCO statements, most recently the 2005 SCO Communiqué calling for an eventual withdrawal of U.S. forces in Central Asia.

By and large, Beijing has been successful in leveraging its relations in Central Asia and within the SCO to achieve its three key strategic interests. However, Beijing's interests and policies in Central Asia still face challenges. To date, the SCO has acted mainly as a "talk shop," with few substantive mechanisms to translate words into practice. This may change now that the SCO Secretariat is operational in Beijing and the Regional Antiterrorism Structure (RATS) has begun to function in Tashkent. However, it is still too early to tell. Second, China has not entirely given up all of its heavy-handed ways, and has used its size, power, and economic might to gain advantage in negotiations, particularly in discussions over border demarcation and security assistance to monitor the Uyghur diaspora in Central Asia. Central Asians continue to harbor concerns as to China's long-range intentions in the region, which may ultimately limit Beijing's room to maneuver. Most important, though, is the understanding that while China may offer great potential for economic and security cooperation in Central Asia, the United States and Russia will continue to offer more in the way of concrete security and economic benefits over the near- to medium-term.

Domestic Security

While China's broad strategic interests provide longer-term direction to its Central Asian policies, security concerns present the most pressing and immediate factors shaping China's approach to the region. These challenges include the aforementioned "three evils" of terrorism, separatism, and extremism, and involve developments within and beyond Chinese borders: from separatist-minded Uyghur groups in China's Xinjiang province to illicit trans-border activity such as trafficking in drugs, guns, and people. By strengthening its relationships with the Central Asian states, Beijing hopes to combat these problems before they reach the Chinese border.⁴

While developments within Xinjiang are largely addressed by Chinese internal security forces, developments in the province play into China's relationship with Central Asia when Beijing believes there is *external* support for what it considers an *internal* problem. Primarily, it is the Uyghur diaspora living in Central Asia that plays directly into Chinese diplomacy in the region. The diaspora is predominantly concentrated in Kyrgyzstan and Kazakhstan, with 50,000 and 180,000 Uyghurs respectively, many of whom are entrepreneurs and have achieved middle class status—not the terrorists China fears them to be. Most Uyghurs in Central Asia are not politically active, but those who make up a vocal minority.

To stop cross-border cooperation between the Uyghurs in Xinjiang and Uyghur, as well as between pan-Turkic, or pan-Islamic groups in Central Asia, China, in addition to the pressure it puts on individual Central Asian states to monitor and control their Uyghur population, promoted the establishment of the Regional Antiterrorism Center in Tashkent, formally launched in June 2004. It is unclear whether the center will be primarily an information exchange hub such as Interpol, or if it will develop some sort of rapid response mechanism over time. Since the 1999 Bishkek SCO Summit when the idea was first proposed, the idea of using the SCO to fight terrorism and other regional security threats has become a centerpiece of the organization, and the most salient factor in building practical cooperation to move the SCO beyond being a discussion forum.

As China has begun to realize that instability in Central Asia can affect its national security beyond the situation in Xinjiang, Beijing has supported a host of new multilateral and bilateral programs, including the announcement at the 2004 SCO Summit that group would take up a new initiative to address security issues beyond terrorism. Plans are underway to cooperate on emergency response activities, drug trafficking, and law enforcement cooperation.⁵ This new drug initiative will be folded into the ongoing counterterrorism agenda stemming from the belief that the drug trade in Central Asia is financing the various terrorist and organized crime groups that threaten the Central Asian governments, China, and Russia. Additionally, members of the SCO, particularly Russia, Kazakhstan, and Tajikistan, have

⁴For a more recent, detailed description of the Xinjiang issue, see *Xinjiang: China's Muslim Borderland*, Edited by S. Frederick Starr, Johns Hopkins University, Fall 2004.

⁵"Tashkent Declaration of the Head of Member States of the Shanghai Cooperation Organization," June 21, 2004 available at http://www.shaps.hawaii.edu/fp/russia/2004/20040621_sco_decl-eng.html.

discussed the creation of an SCO Rapid Deployment Force (RDF), perhaps mirroring the Russian CSTO RDF in Kyrgyzstan, but China has yet to support this idea.⁶

Perhaps most significantly, the nations of the SCO, except Uzbekistan, conducted a major, multi-day exercise in early August 2003 simulating responses to various counterterrorism scenarios in Kazakhstan and China. This exercise, held in eastern Kazakhstan and Xinjiang, included over 1,000 troops, many of them special operations forces, and was much more prominent in scope, size, duration, and media coverage than the October 2002 exercise held between Kyrgyzstan and China.⁷

To further ensure regional security China has initiated a growing bilateral security assistance program with the Central Asian states, particularly in the areas of border control, military aid, and intelligence sharing. China donated prefabricated border outposts, jeeps, and other monitoring equipment to Kyrgyzstan. China is assisting Tajikistan in guarding their common border as Tajikistan begins to shift resources for the assumption of the responsibility for the security of the Tajik-Afghan border from Russian forces. In 2000, when Uzbek forces faced an IMU flare-up, China was the first to provide Uzbekistan with emergency military equipment, including flak jackets, night vision equipment, and sniper rifles. China gave 10 million Yuan (U.S.\$1.2 million) worth of military-technical assistance to Kyrgyzstan in 2002, including firearms and telecom systems to combat terrorism, and, in February 2003, China donated police facilities to the Internal Affairs Ministry of Kazakhstan. In addition to this material aid, China has provided training for various Central Asian military officials and there is continued intelligence sharing between the different Central Asian nations and China, most of which is focused on counterterrorism.

This assistance has continued to increase over the last several years, with China becoming a significant source for money, equipment, and training.⁸ China's contributions still do not compete with those of the United States and Russia, but, from the Central Asian perspective, these allotments do not come with the same strings attached, particularly human rights criticism from the United States, or Russian demands of allegiance. This factor is central to the growing bond between China and Central Asia.

Stability Along the Border

A third important set of goals and policies shaping China's active Central Asian diplomacy concerns the settlement of border disputes. Reaching settlements on disputed borders, which had been sources of tension during the Cold War, was important to Beijing in the early 1990s both to advance its cooperative agenda with Central Asia, and to devote more attention to other post-Cold War strategic challenges. The SCO and its predecessor, the Shanghai Five, played a critical role in legitimizing and institutionalizing these agreements. The most significant accomplishment of the group was the negotiation of the 1996 Shanghai Five "Agreement on Confidence-Building in the Military Field Along the Border Areas" and the 1997 "Agreement on Reducing Each Other's Military Forces along the Border Regions." These treaties delineated and demarcated the border and created a package of military confidence building measures that included a pullback of troops and equipment to 100 kilometers off the common borders, verification procedures, and pre-notification requirement for exercises and other military activities near the border. They also established a series of military-to-military exchanges. Today, the borders between China, Central Asia and Russia are virtually settled and have been a source of stability for almost a decade.⁹ As stated in the 2000 SCO Summit Communiqué, the 1996 and 1997 agreements had "helped build for the first time, in the border belt of more than 7,000 km, a region of trust and transparency where military activities are predictable and monitorable."¹⁰

In fact, demarcating and demilitarizing the borders with its Central Asian neighbors (including Russia) became the foundation on which Sino-Central Asia relations were built. It has provided China and its Central Asian neighbors a measure of

⁶"Tajik President Calls For SCO Rapid-Reaction Force," *Eurasianet's Kyrgyzstan Daily Digest*, accessed on June 28, 2005 at www.eurasianet.org/resource/uzbekistan/hypermail/news/0046.shtml.

⁷Dumont, Malia, "'Cooperation 2003': Style, Substance, and Some Surprises," *CEF Monthly*, September 2004.

⁸While there are no official statistics on Chinese aid to Central Asia, data compiled by the author indicate assistance in the form of donated equipment (military and commercial use), grants, and loans has increased dramatically over the last five years.

⁹While all of the border settlements have been negotiated and approved by the various heads of state, some of the agreements, most notably the Chinese-Tajik border treaty, has yet to be ratified by the legislative branch.

¹⁰"Full Text of Dushanbe Statement of Shanghai Five," July 5, 2000.

peace and security, allowing them to expend their energy on more critical and worrisome issues, such as internal development and pressing diplomatic issues, while setting out a model for cooperative security relations among former adversaries. And this is a particularly important aspect of China's relations with Central Asia as compared to its relations with other nations in the developing world; creating a source of good will centered around the common land border and the settlement of territorial disputes. Now, with border demarcation and demilitarization between China and its Central Asian neighbors virtually complete, remaining border security issues can be placed in the "cooperative security" column of their relationships under the SCO.

Energy and Trade

Finally, China has important economic interests in Central Asia. Chinese investments are wide ranging, including hotels, factories, and natural resource extraction operations, and the presence of Chinese goods in Central Asian bazaars is ubiquitous. According to official Kazakh sources, there are now more than 20 accredited Chinese companies and some 600 joint ventures in the country.¹¹ In 2003, China exported \$1.9 billion worth of goods to Central Asia while importing \$2 billion from the region as a whole.¹² While these numbers are low, they are expected to grow, especially as more Kazakh energy resources come online.

Nevertheless, many analysts see significant promise in economic and financial relations between China and Central Asia over the medium- to long-term, especially in the development of the region's enormous energy resources to fuel China's anticipated economic growth and burgeoning energy demands. In 2015, China's projected oil needs will be 7.4 million barrels a day (bb/d) (up from 3.4 million bb/d in 2002), 50 percent of which will be made up by imports. Natural gas will also be a much-needed foreign-produced commodity in the years ahead. In order to diversify its sources of supply and increase its energy security, China wants to establish Central Asia, particularly Kazakhstan and to some degree Turkmenistan, as guaranteed sources of oil and gas. To this end, China's most significant area of economic cooperation in Central Asia has been its investment in the Kazakh energy sector. In 2001, total Chinese imports from Kazakhstan were just over \$900 million, chiefly representing the 19,600 barrels a day of crude oil shipped in by rail. To help meet China's growing demand, the China National Petroleum Company (CNPC) invested \$4.3 billion in the Kazakh state oil company Aktubinskneft in June 1997, entitling China to a 63 percent stake in three fields with a total estimated oil reserve of 1 billion barrels. Also as part of this agreement, China and Kazakhstan agreed to build a 3,000 km pipeline from the Caspian Sea area to Xinjiang. The pipeline will have an initial output estimated at 10 million tons a year (to double later) and will fit into the East-West Pipeline from Xinjiang's Tarim Basin to China's East Coast. The China-Kazakhstan line is expected to cost over \$3 billion and began construction of the third and final phase in March 2005. At this point, the pipeline has been deemed uneconomical by many experts, but reflects China's energy strategy of securing sources at whatever cost. This is particularly important given the failure of China to secure the import of Russian oil from Siberia. Foreseeing future supplies that could be added to its patchwork of worldwide energy sources, China has continued to invest in other Kazakh, Kyrgyz, Turkmen, Uzbek, Tajik, Georgian, and other fields. However, none of these have offered the same potential as China's main Kazakh field. Additionally, China has just initiated negotiations with the Kazakh government to import natural gas following a similar pipeline route starting in 2008.

Additionally, Chinese export of cheap consumer goods to Central Asia, the shipment of Kazakh oil by rail, and Xinjiang's continuously developing infrastructure, which has led to an increased import of raw materials such as iron ore, steel, and non-ferrous metals, copper to upgrade its power and telecommunication grids, and fertilizer for newly irrigated fields, underscores the importance of building more transportation links between China and Central Asia. Projects to achieve this goal include a new rail link being built between Xinjiang and Uzbekistan, which will pass through Kyrgyzstan and possibly another that will include Tajikistan. This connects with the \$250 million European Bank for Reconstruction and Development (EBRD) sponsored Transport Corridor Europe Caucasus Asia (TRACECA) project to

¹¹ Swanstrom, Niklas, "Chinese Business Interests in Central Asia: A Quest for Dominance," Central Asian-Caucasus Analyst, June 18, 2003; "Chinese Leader Hu Jintao Visits Astana," RFE/RL, June 07, 2003; and information provided by background sources.

¹² IMF, *Direction of Trade Statistical Yearbook*, Washington DC, 2004; note: these numbers are often less than reliable and do not account for the vast unofficial trade between these countries, all suggesting the amount of cross-border trade is higher than recorded.

build the new Silk Road from China to Europe, and other similar projects. Additional infrastructure projects include the already completed Urumqi-Almaty rail line and a new 360 km road between Lake Issyk-Kul in Kyrgyzstan and Aksu in Xinjiang, to be built by China at a cost of \$15 million.^{13,14}

Importantly, the SCO has begun to play a much more significant role in Chinese-Central Asian economic relations. In the almost two years since the 2003 SCO St. Petersburg Summit, the organization has dramatically stepped up its focus on economic cooperation. An ambitious 20-year plan was launched to reduce barriers to trade and promote regional economic integration. A multinational transportation pact is to be completed by the end of 2005 that should improve the infrastructure of trade in the region. This process has already led to further Chinese investment in road and rail projects cited above, and the construction of new crossings and customs house along the Chinese border with Central Asia. Four additional working groups have recently been established to address cooperation on e-commerce, customs, quality inspection, and investment promotion.¹⁵ And finally, a new \$20 million SCO Development Fund and Business Forum will be launched to promote regional trade and investment into new business and assistance projects.

China's new economic diplomacy with Central Asia has seen a sharp increase in the amount of economic assistance, credits, and loans China is providing to Central Asian governments. At the last SCO summit held in Tashkent in June of 2004, President Hu Jintao pledged \$900 million in credits and loans for Central Asian nations to buy Chinese goods. Similarly, China has provided Uzbekistan with a low-interest loan and grant of 50 million yuan (over \$6 million) for land irrigation projects, as well as \$3.62 million worth of medical equipment; Tajikistan with 25 million yuan (about U.S.\$3 million) for the implementation of social and economic programs; and Turkmenistan with grants and credits worth 45 million yuan, (about U.S.\$5.4 million) for Turkmengaz to buy equipment and spare parts for its repair plant.¹⁶

Overall, China's trade with Central Asia has been a boon to the region, and while the amounts are relatively low, the potential for growth is enormous. China's dynamic economy could be a powerful engine for Central Asian development, and its close proximity could provide Central Asian states with an export route to the burgeoning markets of the Pacific. And while other nations, such as Japan and Korea, have made headway into the region's markets, it is China's mammoth size and proximity, coupled with Central Asia's natural resource wealth that will inextricably link China and Central Asia over the coming decades.

The Future of the Shanghai Cooperation Organization

As indicated, the Shanghai Cooperation Organization plays a vital role in all aspects of China's policy towards Central Asia. It has evolved into China's main vehicle by which China engages with Central Asia, particularly in the security and counterterrorism area. And recently, the SCO has become the main driver for regional economic reform (involving China), particularly in updating the economic infrastructure of the region.

China's future successes and failures in Central Asia will be determined, in large part, by the viability of the Shanghai Cooperation Organization. Now that the SCO has two working organs, the Secretariat in Beijing and the RATS in Tashkent, it will be playing an even more active role in the region. This is quite remarkable given the SCO's humble beginning as a border negotiation forum, which many experts assumed would fail in its early attempts to evolve into a multi-faceted cooperative organization. The SCO has still not had many tangible successes, but the fact that it has endured over the last eight years and has just begun a new phase of development bodes well for its future impact on the region. Yet, member nations will have to commit even more resources, energy, and political capital to make this organization truly viable, a first in the history of Central Asian multilateral organizations. The political will seems to exist, but it remains to be seen if Russia and China actually will commit scarce resources to this effort.

Most recently, the SCO took steps at its July 2005 summit to further cement its development and place as a potential regional leader. At the meeting the SCO an-

¹³"Chinese President Urges SCO Economic Cooperation," *People's Daily*, Friday, May 30, 2003.

¹⁴Swanstrom; "Chinese Leader Hu Jintao Visits Astana," RFE/RL, June 07, 2003; and information provided by Fred Starr, Chairman of the Central Asia-Caucasus Institute.

¹⁵Speech by Premier Wen Jiabao at the Meeting of Prime Ministers of Member States of the Shanghai Cooperation Organization (SCO), September 23, 2004; downloaded from Foreign Ministry of the People's Republic of China (<http://www.fmprc.gov.cn/eng/zxxx/t162430.htm>) September 28, 2004.

¹⁶Information compiled by the China-Eurasia Forum, www.chinaeurasia.org, October 2004.

nounced practical steps to advance security and economic cooperation among the members. Additionally, India, Pakistan, and Iran were given observer status, joining Mongolia which was admitted as an observer in 2004; additions whose long term affect is unclear, especially given Iran's international pariah status in the West and India and Pakistan's tendency to drown any international organization in which they are members with discussions on Kashmir. And partnerships with ASEAN, CIS, and CSTO were announced, as well the formation of an SCO-Afghanistan Contact group at the 2005 summit.¹⁷

Perhaps the most striking announcement, though, was the Communiqué's call for the United States to draw up a timetable for giving up its bases in Kyrgyzstan and Uzbekistan when "active" counterterrorism operations ended in Afghanistan.¹⁸ This represents a significant up-tick in anti-hegemonic (or anti-United States) language not seen since July 2001. Yet taken together with increased calls for a multipolar world, as seen in this document and the recent China-Russia Statement on the 21st Century World Order, this can be explained in the context of strategic positioning and international politics. Evidence suggests that language on U.S. bases was an Uzbek initiated—and Russian supported—statement responding to U.S. and Western criticism of the government-led massacre at Andijon. The Chinese government was content to allow the statement even though it has no immediate intention of challenging the United States' presence in Central Asia.¹⁹ This statement is nothing more than a warning shot fired by Uzbekistan at the U.S. with the message: "We think you are trying to undermine our government. Stop or we will revoke basing rights and align more closely with China and Russia." The Chinese refused to reject this language because it serves a subtle reminder to the United States that China has made impressive gains in Central Asia and has established itself as a less costly outside patron than the United States (less costly in that it will not criticize developing states on the human rights practices or tie their aid to progress in this area). This message, though, should not be mistaken for an indication that China is ready to challenge the U.S. presence in Central Asia. China's security interests are still served by the U.S. presence and China's own strategic interests are not helped by creating tension with the United States over Central Asia when so many other issues, such as internal economic growth and the future of Taiwan, are so prominent on the leadership's agenda. While the departure of U.S. forces from the region may serve the long-term interests of China (and Russia), these statements must be recognized for what they mean today. They are political and diplomatic statements that serve to strengthen the hands of China, Russia, Uzbekistan, and the other SCO members when dealing with the United States. This is the essence of international power politics: SCO member nations are using their combined voice to leverage a strengthened strategic position against the United States to achieve their own individual goals. With the exception of Uzbekistan, the SCO members are not interested today in the removal of American bases or going toe-to-toe with the United States in Central Asia, but are interested in using the potential revocation of basing rights as a bargaining chip in other aspects of their relationship with the United States.

The SCO is not the new Warsaw Pact. It is its own entity based on the self-interest of its members; members that have consistently done what is in their own best interest at the expense of their neighbors for the last 15 years since independence. The United States maintains its own independent relationship with the Central Asian states based on mutual self-interest, a relationship that will not easily be disrupted by the promise of Chinese or Russian patronage. It is important to remember that the United States achieved more in the six months after September 11, 2001 for Central Asian security than the SCO did in six years, and while there is great cultural affinity for Russia within Central Asia, most do not miss the heavy handed tactics of their former Soviet ruler. Thus, while Uzbekistan may turn away from the West in fear that the United States and Europe is seeking to undermine the Karimov regime, the new democratic government of Kyrgyzstan as well as the oil-

¹⁷"Declaration of Heads of Member States of Shanghai Cooperation Organization," July 05, 2005; "Russia hails signing of document on SCO-CIS cooperation," *Xinhua*, April 13, 2005, available at http://news.xinhuanet.com/english/2005-04/14/content_2825941.htm; "Memorandum of Understanding Between Secretariats of SCO and ASEAN," available at <http://www.aseansec.org/ASEAN-SCO-MOU.pdf>; Putin: CSTO to establish anti-drug structure, *RIA Novosti*, accessed on June 23, 2005 at <http://en.rian.ru/world/20050623/40751672.html>.

¹⁸"U.S. urged to give bases deadline," BBC News Online, accessed July 5, 2005 at <http://news.bbc.co.uk/1/hi/world/asia-pacific/4652175.stm>; "SCO sends strong signals for West to leave Central Asia," *People's Daily*, accessed July 8, 2005 at http://english1.people.com.cn/200507/08/eng20050708_194907.html; "China-Russia Statement on the 21st Century World Order," July 2, 2005.

¹⁹"Kyrgyzstani Figures Say SCO Position on U.S. Bases Linked to Uzbekistani Leader," *Interfax-AVN*, July 6, 2005.

exporting rulers of Kazakhstan seem content to engage with the West. The SCO is not a monolith or military alliance, but rather an organization of fickle member states seeking to meet their individual goals.

In the end, China's engagement in Central Asia will be heavily dependant on the SCO's development. The goals of the SCO clearly reflect the policy interests of China, and China will continue to use the organization to manage its re-emergence as a regional player. Similarly, the Central Asian's benefit materially and politically from the organization and are happy to use Chinese patronage, funneled through the SCO, to their advantage. It is when this internal dynamic shifts away from cooperation to competition, whether it be a Sino-Russian or Uzbek-Kazakh schism, that the true strength and endurance ability of the SCO will be revealed.

Implications for United States Policy in Central Asia

A key issue for U.S. policymakers in the region—does China's growing prominence in Central Asia negatively affect U.S. interests?—cannot yet be fully answered. At present, and for the near- to medium-term, the United States should not be negatively concerned about China's role in the region, and, in some respects should welcome Beijing's approach in Central Asia. There are obvious shared interests between Washington and Beijing in this part of the world, and it is logical for the two, as well as Moscow, to cooperate in addressing common challenges. These problems include, among others, terrorism, religious extremism, and drug trafficking. The problems of Central Asia are too numerous and too complex to be addressed effectively by the United States alone. Central Asians also lack the capacity to address them individually, and have proven incapable of pulling together more cooperatively to address their political, social and economic challenges. Washington should encourage multilateral solutions and look for opportunities to engage with China (and Russia) whenever possible. Engaging today will help build the trust and confidence needed to reduce possible tensions over Central Asia that could possibly arise in the future between the three powers, whether it be over the direction of Kazakh energy exports or the remaining U.S. bases in the region.

Still, the United States should pay close attention to the development of China's relations with the Central Asian states to guarantee that China does not become a problematic influence in the region. There are always worries that China will undermine U.S. goals of political reform or try to coerce the Central Asian regimes into downgrading their ties with the United States if Beijing feels threatened. But those fears can be mitigated and those instincts do not seem to get much attention currently in Beijing. Also, as Central Asian and Russian oil and gas begin to flow to market, economic competition among the great powers will likely become harsher, especially as these energy resources will be coming online while the U.S. still has a military presence in the region. Over the longer-term, it is possible too that China (and even Iran) will become a more important security presence in Central Asia. But by being vigilant and watching these developments, the United States can seek to actively manage its engagement with these outside powers to reduce tensions and more affectively achieve its goals in Central Asia.

Conclusion

China's emergence in Central Asia will continue to grow based on a long history of interaction and clearly defined interests. China has rediscovered its place in the region and is developing pragmatic channels to achieve its interests there. Successes are growing, particularly in the fields of security and natural resource extraction, and a future of increasingly intense interaction looks inevitable. However, China's relations with Central Asia, in and of themselves, are not a major foreign policy priority for Beijing. For the foreseeable future, Beijing's Central Asian diplomacy and strategy is more of a means to other ends, particularly the promotion of its overall foreign policy and diplomatic goals, management of Sino-American and Sino-Russian relations, continued domestic economic development, and dealing with security concerns in Xinjiang. By and large, China pays close attention to Central Asia so it does not *become* a problem. On the other side of the coin, Central Asian nations, at present, have more to gain from the United States and Russia than from China, making their ties with China a lower, though growing, priority for them as well.

China's chief objective is *strategic denial*: act to deny the rise of elements that will challenge China's internal security, deny the use of Central Asia by the United States to contain China, and deny a Russian monopoly of influence on its border. China will most likely give significant attention only to those problems that directly affect its vital interests, such as counterterrorism and other border security and transnational questions. Central to this will be the attention paid to the role of the Uyghurs and Xinjiang in China-Central Asia relations. It is also clear that China's goal is to foster regional cooperation only to the point that it fits into its own na-

tional interest. If China can achieve its aims bilaterally and not through the SCO, it will. However, the SCO provides a very useful vehicle to address transnational threats. Moreover, continuing problems in Central Asia and the region's inability to use collective action will minimize China's region-wide reach, leaving open the likelihood that Beijing will have considerable influence in some states, such as Kyrgyzstan and Kazakhstan, but considerably less in others. China's region-wide presence will be most affected, though, by the action of the United States and Russia. The United States is the most important near-term ally of the Central Asian states and can dictate the future shape of the regional security situation to a significant degree. Russia, too, has enduring importance to the region and can undermine many of China's goals if it chooses to exercise its many levers of influence.

In sum, China is on the rise in Central Asia. The United States and Russia will have to deal with a more comprehensive Chinese presence in the region in the years ahead. Diplomatic and strategic hedging by external powers has already begun, and Central Asia has become an important piece on the global chessboard. All sides are using it to advance their international agendas. This is not a return to the "Great Game" of the 19th century, however. China, Russia, and the United States are too integrated with each other to threaten a clash over what is still a second-tier priority compared to more pressing issues like North Korea, Iraq, the proliferation of weapons of mass destruction, and Taiwan. However, given the intermingling of Great Power interests in this region, increased tension is possible. There is room for cooperation in Central Asia and no need for restrictive alliances. In the best scenarios, the United States, China, and Russia will recognize their convergence of interests, and work together to shape a more secure, prosperous, and stable Central Asia.

**STATUTORY MANDATE OF THE U.S.-CHINA ECONOMIC AND SECURITY
REVIEW COMMISSION**

Pursuant to Public Law 108-7, Division P, enacted February 20, 2003

RESPONSIBILITIES OF THE COMMISSION.—The United States-China Commission shall focus, in lieu of any other areas of work or study, on the following:

PROLIFERATION PRACTICES.—The Commission shall analyze and assess the Chinese role in the proliferation of weapons of mass destruction and other weapons (including dual use technologies) to terrorist-sponsoring states, and suggest possible steps which the United States might take, including economic sanctions, to encourage the Chinese to stop such practices.

ECONOMIC REFORMS AND UNITED STATES ECONOMIC TRANSFERS.—The Commission shall analyze and assess the qualitative and quantitative nature of the shift of United States production activities to China, including the relocation of high-technology, manufacturing, and R&D facilities; the impact of these transfers on United States national security, including political influence by the Chinese Government over American firms, dependence of the United States national security industrial base on Chinese imports, the adequacy of United States export control laws, and the effect of these transfers on United States economic security, employment, and the standard of living of the American people; analyze China's national budget and assess China's fiscal strength to address internal instability problems and assess the likelihood of externalization of such problems.

ENERGY.—The Commission shall evaluate and assess how China's large and growing economy will impact upon world energy supplies and the role the United States can play, including joint R&D efforts and technological assistance, in influencing China's energy policy.

UNITED STATES CAPITAL MARKETS.—The Commission shall evaluate the extent of Chinese access to, and use of United States capital markets, and whether the existing disclosure and transparency rules are adequate to identify Chinese companies which are active in United States markets and are also engaged in proliferation activities or other activities harmful to United States security interests.

CORPORATE REPORTING.—The Commission shall assess United States trade and investment relationship with China, including the need for corporate reporting on United States investments in China and incentives that China may be offering to United States corporations to relocate production and R&D to China.

REGIONAL ECONOMIC AND SECURITY IMPACTS.—The Commission shall assess the extent of China’s “hollowing-out” of Asian manufacturing economies, and the impact on United States economic and security interests in the region; review the triangular economic and security relationship among the United States, Taipei and Beijing, including Beijing’s military modernization and force deployments aimed at Taipei, and the adequacy of United States executive branch coordination and consultation with Congress on United States arms sales and defense relationship with Taipei.

UNITED STATES-CHINA BILATERAL PROGRAMS.—The Commission shall assess science and technology programs to evaluate if the United States is developing an adequate coordinating mechanism with appropriate review by the intelligence community with Congress; assess the degree of non-compliance by China and [with] United States-China agreements on prison labor imports and intellectual property rights; evaluate United States enforcement policies; and recommend what new measures the United States Government might take to strengthen our laws and enforcement activities and to encourage compliance by the Chinese.

WORLD TRADE ORGANIZATION COMPLIANCE.—The Commission shall review China’s record of compliance to date with its accession agreement to the WTO, and explore what incentives and policy initiatives should be pursued to promote further compliance by China.

MEDIA CONTROL.—The Commission shall evaluate Chinese government efforts to influence and control perceptions of the United States and its policies through the internet, the Chinese print and electronic media, and Chinese internal propaganda.

FACT SHEET**U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION****ESTABLISHMENT:**

The Commission was created in October 2000 by the Floyd D. Spence National Defense Authorization Act for 2001 § 1238, Pub. L. No. 106-398, 114 STAT. 1654A-334 (2000) (codified at 22 U.S.C. § 7002 (2001)), as amended, and the “Consolidated Appropriations Resolution of 2003,” Pub. L. No. 108-7, dated February 20, 2003.

PURPOSE:

To monitor, investigate, and submit to congress an annual report on the national security implications of the bilateral trade and economic relationship between the United States and the People’s Republic of China, and to provide recommendations, where appropriate, to Congress for legislative and administrative action.

Public Law 108-7 directs the Commission to focus its work and study on the following nine areas: proliferation practices, economic reforms and U.S. economic transfers, energy, U.S. capital markets, corporate reporting, regional economic and security impacts, U.S.-China bilateral programs, WTO compliance, and media control by the Chinese government.

COMPOSITION:

The Commission is composed of 12 members, three of whom are selected by each of the Majority and Minority Leaders of the Senate, and the Speaker and the Minority Leader of the House. The Commissioners serve two-year terms.

COMMISSIONERS:

Hon. C. Richard D’Amato, Chairman; Roger W. Robinson, Vice Chairman; Carolyn Bartholomew, George Becker, Stephen Bryen, Thomas Donnelly, June Teufel Dreyer, Hon. Patrick A. Mulloy, Hon. William A. Reinsch, Hon. Fred D. Thompson, Michael R. Wessel, and Larry M. Wortzel (brief bios are attached).

STAFF:

The Commissioners are supported by a professional substantive and administrative staff with extensive backgrounds in trade, economics, weapons proliferation, foreign policy, and U.S.-PRC relations. Some are fluent or proficient in Chinese (Mandarin), and most have significant prior working and traveling experience in China and Taiwan. The staff is headed by T. Scott Bunton, Commission Executive Director (brief bio is attached).

WEB SITE:

The Commission’s web site provides the Commission’s complete charter, hearing schedule, hearing transcripts, and selected research papers, and economic and trade data www.uscc.gov.

The Hon. C. Richard D'Amato (Chairman)

Maryland attorney; former delegate Maryland House of Delegates; former Counsel to Senator Robert C. Byrd (WV). Reappointed by Senate Democratic Leader Tom Daschle for a term expiring December 31, 2005. Served as Commission Chair and Vice-Chairman beginning in April 2001 and was unanimously approved as Chairman for report cycle 2004 to 2005.

Roger W. Robinson, Jr. (Vice Chairman)

President and CEO, Conflict Securities Advisory Group, Inc.; former Senior Director of International Economic Affairs at the National Security Council. Reappointed by Senate Majority Leader Bill Frist for a term expiring December 31, 2005. Served as the Commission Chair beginning October 2002 through July 2004 and was unanimously approved as Vice-Chairman for report cycle 2004–2005 on July 19, 2004.

Carolyn Bartholomew

Former Chief of Staff, Counsel, Legislative Director, and Foreign Policy Advisor to U.S. House of Representatives Democratic Leader Nancy Pelosi; former Professional Staff Member on the House Permanent Select Committee on Intelligence. Reappointed by House Democratic Leader Nancy Pelosi for a term expiring December 31, 2005.

George Becker

Vice President, Executive Council, AFL–CIO; former International President, United Steelworkers of America. Reappointed by House Democratic Leader Nancy Pelosi for a term expiring December 31, 2005.

Stephen D. Bryen

President of Finmeccanica, Inc.; former Deputy Under Secretary of Defense and founder and First Director of the Defense Technology Security Administration. Reappointed by House Speaker J. Dennis Hastert for a term expiring December 31, 2005.

Thomas Donnelly

Resident fellow in defense and security policy studies at the American Enterprise Institute; former policy group director of the House Armed Services Committee; former editor of Army Times and executive editor of the National Interest. Appointed by Senate Majority Leader Bill Frist for a two-year term expiring December 31, 2006.

June Teufel Dreyer

Professor of Political Science at the University of Miami; Senior Fellow of the Foreign Policy Research Institute. Reappointed by House Speaker J. Dennis Hastert for a term expiring on December 31, 2005.

The Hon. Patrick A. Mulloy

Adjunct Professor of International Trade Law at Catholic University and George Mason University law schools; former Assistant Secretary of Commerce for Market Access and Compliance; former General Counsel, U.S. Senate Banking Committee. Reappointed for a third two-year term upon the recommendation of the Senate Democratic Leader beginning January 1, 2005 and expiring December 31, 2006.

The Hon. William A. Reinsch

President, National Foreign Trade Council; former Undersecretary of Commerce for Export Administration; former legislative assistant to Senator John Heinz (PA) and Senator John D. Rockefeller, IV (WV). Reappointed by Senate Democratic Leader Tom Daschle for a term expiring December 31, 2005.

The Hon. Fred D. Thompson

Attorney and former United States Senator from Tennessee and member of the Senate Select Committee on Intelligence. Former Special Counsel to both the Senate Select Committee on Intelligence and Senate Committee on Foreign Relations. Appointed by Senate Majority Leader Bill Frist for a two-year term expiring December 31, 2006.

Michael R. Wessel

Senior Vice President, Downey McGrath Group; former Counsel to Congressman Richard A. Gephardt (MO). Reappointed by House Democratic Leader Nancy Pelosi for a term expiring December 31, 2006.

Larry M. Wortzel

Visiting Fellow at The Heritage Foundation; former Director of the Strategic Studies Institute of the U.S. Army War College; former Army Attache at the U.S. Embassy in China. Reappointed by House Speaker J. Dennis Hastert for a term expiring December 31, 2006.

T. Scott Bunton—Executive Director

Served from 1998 to 2002 as Deputy Under Secretary of Commerce for Export Administration and in 2002–2003 worked in the Transition Planning Office in the Executive Office of the President that was responsible for “standing up” the Department of Homeland Security when it was established by law. Previously served as national security advisor, policy director, and chief of staff to two U.S. Senators, staff director of a Senate leadership Committee, and staff designee to the Senate Committee on Intelligence.

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