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**U.S.-CHINA ECONOMIC AND  
SECURITY REVIEW COMMISSION**

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The Commission was created on October 30, 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 by the Treasury and General Government Appropriations Act for 2002 § 645 (regarding employment status of staff) & § 648 (regarding changing annual report due date from March to June), Pub. L. No. 107-67, 115 STAT. 514 (Nov. 12, 2001); as amended by Division P of the "Consolidated Appropriations Resolution, 2003," Pub. L. No. 108-7 (Feb. 20, 2003) (regarding Commission name change, terms of Commissioners, and responsibilities of Commission); as amended by Pub. L. No. 109-108 (H.R. 2862) (Nov. 22, 2005) (regarding responsibilities of Commission and applicability of FACA); as amended by Pub. L. No. 110-161 (Dec. 26, 2007) (regarding changes in annual report due date; submission of financial reports; printing and binding of Congressional reports; employee compensation and performance reviews; and applicability of House rules for travel by members and staff).

The Commission's full charter <http://www.uscc.gov/about/charter.php> and Statutory Mandate <http://www.uscc.gov/about/overview.php> are available via the World Wide Web.

U.S.-CHINA ECONOMIC AND SECURITY REVIEW COMMISSION

NOVEMBER 9, 2011

The Honorable Daniel Inouye,  
*President Pro Tempore of the U.S. Senate, Washington, DC 20510*  
The Honorable John Boehner,  
*The Honorable Nancy Pelosi,*  
*Speaker of the U.S. House of Representatives, Washington, DC 20510*

DEAR SENATOR INOUYE AND SPEAKER BOEHNER:

On behalf of the U.S.-China Economic and Security Review Commission, we are pleased to transmit the Commission's 2011 Annual Report to the Congress—the ninth major Report presented to Congress by the Commission—pursuant to Public Law 106–398 (October 30, 2000), as amended by Public Law No. 109–108 (November 22, 2005). This report responds to the mandate for the Commission “to monitor, investigate, and report to Congress on the national security implications of the bilateral trade and economic relationship between the United States and the People’s Republic of China.” In this Report, the Commission reached a broad and bipartisan consensus; it approved the Report unanimously, with all 12 members voting to approve and submit it.

In accordance with our mandate, this Report, which is current as of November 9, includes detailed treatment of our investigations of the areas identified by Congress for our examination and recommendation. These areas are:

- **PROLIFERATION PRACTICES**—The role of the People’s Republic of China in the proliferation of weapons of mass destruction and other weapons (including dual-use technologies), including actions the United States might take to encourage the People’s Republic of China to cease such practices;
- **ECONOMIC TRANSFERS**—The qualitative and quantitative nature of the transfer of United States production activities to the People’s Republic of China, including the relocation of high technology, manufacturing, and research and development facilities, the impact of such transfers on United States national security, the adequacy of United States export control laws, and the effect of such transfers on United States economic security and employment;
- **ENERGY**—The effect of the large and growing economy of the People’s Republic of China on world energy supplies and the role the United States can play (including joint research and development efforts and technological assistance), in influencing the energy policy of the People’s Republic of China;
- **UNITED STATES CAPITAL MARKETS**—The extent of access to and use of United States capital markets by the People’s Republic of China, including whether or not existing disclosure and transparency rules are adequate to identify People’s Republic of China companies engaged in harmful activities;
- **REGIONAL ECONOMIC AND SECURITY IMPACTS**—The triangular economic and security relationship among the United States, [Taiwan] and the People’s Republic of China (including the military modernization and force deployments of the People’s

Republic of China aimed at [Taiwan]), the national budget of the People's Republic of China, and the fiscal strength of the People's Republic of China in relation to internal instability in the People's Republic of China and the likelihood of the externalization of problems arising from such internal instability;

- UNITED STATES–CHINA BILATERAL PROGRAMS—Science and technology programs, the degree of noncompliance by the People's Republic of China with agreements between the United States and the People's Republic of China on prison labor imports and intellectual property rights, and United States enforcement policies with respect to such agreements;
- WORLD TRADE ORGANIZATION COMPLIANCE—The compliance of the People's Republic of China with its accession agreement to the World Trade Organization (WTO); and
- FREEDOM OF EXPRESSION—The implications of restrictions on speech and access to information in the People's Republic of China for its relations with the United States in the areas of economic and security policy.

**The Commission conducted its work through a comprehensive set of eight public hearings, taking testimony from over 65 witnesses from the Congress, the executive branch, industry, academia, policy groups, and other experts. For each of its hearings, the Commission produced a transcript (posted on its Web site—[www.uscc.gov](http://www.uscc.gov)). The Commission also received a number of briefings by officials of executive branch agencies, intelligence community agencies, and the armed services, including classified briefings on China's cyber operations and military and commercial aerospace modernization. (The Commission is preparing a classified report to Congress on those topics.)**

Commissioners also made an official delegation visit to China, Hong Kong, and Taiwan to hear and discuss perspectives on China and its global and regional activities. In these visits, the Commission delegations met with U.S. diplomats, host government officials, representatives of the U.S. and foreign business communities, and local experts.

The Commission also relied substantially on the work of its excellent professional staff, and supported outside research in accordance with our mandate.

The Report includes 43 recommendations for Congressional action. Our 10 most important recommendations appear on page 14 at the conclusion of the Executive Summary.

We offer this Report to the Congress in the hope that it will be useful as an updated baseline for assessing progress and challenges in U.S.-China relations.

Thank you for the opportunity to serve. We look forward to continuing to work with you in the upcoming year to address issues of concern in the U.S.-China relationship.

Yours truly,



William A. Reinsch  
*Chairman*



Daniel M. Slane  
*Vice Chairman*

Commissioners Approving the 2011 Report



William A. Reinsch, Chairman



Daniel M. Slane, Vice Chairman



Carolyn Bartholomew, Commissioner



Daniel A. Blumenthal, Commissioner



Peter T. R. Brookes, Commissioner



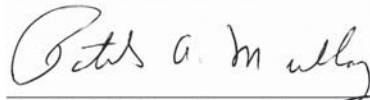
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## EXECUTIVE SUMMARY

### The U.S.-China Trade and Economic Relationship

China is now the second-largest economy in the world and the world's largest manufacturer. Its market exceeds that of the United States in industries such as automobiles, mobile handsets, and personal computers. Although Chinese leaders acknowledge the need to balance their economy by increasing domestic consumption, China continues to maintain an export-driven economy with policies that subsidize Chinese companies and undervalue the renminbi (RMB). While the RMB rose by roughly 6 percent in nominal terms over the last year, it is still widely believed to be substantially undervalued. For the first eight months of 2011, the U.S. trade deficit with China increased 9 percent over the same period in 2010. The U.S. trade deficit with China is now more than half of the total U.S. trade deficit with the world. In the year to date ending August 2011, the United States exported about \$13.4 billion in advanced technology products to China, but imported over \$81.1 billion in advanced technology products from China, for a deficit of about \$67.7 billion. This is a 17 percent increase in the advanced technology products deficit for the same period over the previous year, ending in August 2010.

The Chinese government's special treatment of state-owned enterprises (SOEs) is of particular concern to U.S. businesses, as it can overcome comparative advantages of competitors, thereby harming American economic interests. China's SOEs are also an issue of contention in government procurement, as China seeks to wall off a large portion of its economy from foreign competition.

In 2010, the amount of foreign direct investment (FDI) flowing into China jumped to \$105.7 billion, up from \$90 billion in 2009. Foreign-invested enterprises were responsible for 55 percent of China's exports and 68 percent of its trade surplus in 2010. While some Chinese sectors are now open to foreign sales, huge swathes of the economy are reserved for Chinese firms. Despite Chinese claims that U.S. inward investment policies are protectionist, for the past two years there has been a more than 100 percent year-on-year growth of Chinese investment in the United States. Chinese investments have focused on manufacturing and technology, with an emphasis on brand acquisition. Some critics of China's foreign direct investment in the United States contend that Beijing's efforts are focused on acquiring and transferring technology to Chinese firms.

In March 2011, China ratified its 12th Five-Year Plan (2011–2015), a government-directed industrial policy that focuses on the development and expansion of seven “strategic emerging industries.” The central and local governments will likely continue to combine targeted investment with preferential tax and procure-

ment policies to ensure that Chinese firms emerge as global leaders, or “national champions,” in these industries within the next five years.

China’s indigenous innovation plans that limit government procurement to Chinese companies and China’s continuing lack of enforcement of intellectual property rights are both problematic. In addition, China maintains policies of forced technology transfer in violation of international trade agreements and requires the creation of joint venture companies as a condition of obtaining access to the Chinese market. While the publication of national indigenous innovation product catalogues that favor procurement of Chinese goods over foreign competitors appears to have slowed, local-level catalogues are still in circulation. China continues to be one of the largest sources of counterfeit and pirated goods in the world. The Chinese government itself estimates that counterfeits constitute between 15 and 20 percent of all products made in China and are equivalent to about 8 percent of China’s gross domestic product (GDP). Chinese goods accounted for 53 percent of seizures of counterfeits at U.S. ports of entry in 2010, and the U.S. International Trade Commission estimates that employment in the United States would increase by up to 2.1 million jobs if China were to adopt an intellectual property system equivalent to that of the United States.

The Chinese Communist Party (CCP) relies on economic growth and strict authoritarian rule to maintain control over a factious and geographically vast nation. Socioeconomic issues have been a large driver of protests in China. The party is particularly concerned about inflation, including a 10 percent increase in food prices over the past year, as well as such catalysts of protests as corruption, pollution, and income inequality. In order to maintain control more effectively, the party has created an extensive police and surveillance network to monitor its citizens and react to any potential threat to stability. In 2010, China invested \$83.5 billion in domestic security, which surpassed China’s published military budget of \$81.2 billion for the same year. In early 2011, the central government responded forcefully to the possibility that the unrest in the Middle East might lead to unrest in China. The Chinese government expanded restrictions on online information and access to communication services, reported government propaganda in domestic news outlets, restricted the freedom of foreign journalists, and arrested dissidents with little or no cause.

### **Conclusions**

#### *The U.S.-China Trade and Economic Relationship’s Current Status and Significant Changes During 2011*

- The U.S.-China trade deficit in 2010 set a record high of \$273 billion. The U.S.-China trade deficit now accounts for more than 50 percent of the total U.S. trade deficit with the world.
- Over the last 12 months, the RMB has appreciated by 6 percent. Economists estimate, however, that it remains substantially undervalued. There is increasing grassroots pressure in China to widen the trading band of the RMB and increase the pace of appreciation.

- The Chinese economy, generally, and Chinese exports, in particular, are moving up the value chain. On a monthly basis, the United States now imports roughly 560 percent more advanced technology products from China than it exports to China. Exports of low-cost, labor-intensive manufactured goods as a share of China's total exports decreased from 37 percent in 2000 to 14 percent in 2010.
- China's foreign currency reserves are skyrocketing. A major contributor to this phenomenon is China's continued policy of maintaining closed capital accounts. China's foreign currency reserves currently exceed \$3 trillion, three times higher than the next largest holder of foreign currency reserves, Japan.
- Commensurate with growth in foreign currency reserves, China's domestic money supply is ballooning out of control. Between 2000 and 2010, China's money supply grew by 434 percent. China's money supply is now ten times greater than the U.S. money supply, despite the fact that China's GDP is only one-third as large.
- Such rapid growth in China's domestic money has created strong inflationary pressure. This has helped create a real estate bubble, which resulted in price increases of more than 100 percent in some cities within a handful of years. In September, China's consumer price index topped 6.1 percent across the board and higher in rural areas.
- China has grown more assertive and creative in using WTO procedures to alleviate, eliminate, and avoid certain restrictions in the Accession Protocol. At the same time, the WTO has ruled that China's existing system of state monopoly over imports of cultural products is inconsistent with WTO obligations. China has not yet complied fully with the WTO ruling, and the United States has the right to initiate further proceedings to compel China to do so.

*Chinese State-owned Enterprises and U.S.-China Bilateral Investment*

- China's privatization reforms during the past two decades appear in some cases to have been reversed, with a renewed use of industrial policies aimed at creating SOEs that dominate important portions of the economy, especially in the industrial sectors, reserved for the state's control.
- The Chinese government promotes the state-owned sector with a variety of industrial policy tools, including a wide range of direct and indirect subsidies, preferential access to capital, forced technology transfer from foreign firms, and domestic procurement requirements, all intended to favor SOEs over foreign competitors.
- The value and scope of U.S.-China bilateral investment flows have expanded significantly in the past ten years. However, U.S. direct investment in China is more than 12 times greater than Chinese direct investment in the United States. Official U.S. statistics show that U.S. cumulative FDI in China was

\$60.5 billion in 2010. The Chinese Ministry of Commerce estimated that in 2010, cumulative Chinese FDI in the United States was \$4.9 billion.

- The Chinese government guides FDI into those sectors it wishes to see grow and develop with the help of foreign technology and capital. Foreign investors are frequently forced into joint ventures or other technology-sharing arrangements, such as setting up research and development facilities, in exchange for access to China's market. Meanwhile, large swathes of the Chinese economy are closed to foreign investors. China's investment policies are part of the government's plan to promote the development of key industries in China through access to foreign technology and capital.
- Chinese FDI in the United States is a relatively recent phenomenon and remains very small compared to the U.S. investment in China, but there is great potential for growth. China has stated a desire to diversify its holdings of foreign exchange, estimated at \$3.2 trillion in mid-2011, the majority of which is invested in dollar-denominated debt securities. As with other statistics, there are discrepancies between official U.S. and Chinese statistics on bilateral investment.
- Due to the considerable government ownership of the Chinese economy, provision by Chinese companies of critical infrastructure to U.S. government or acquisition by Chinese companies of U.S. firms with sensitive technology or intellectual property could be harmful to U.S. national interests. The Committee on Foreign Investment in the United States investigates the national security implications of mergers and acquisitions by foreign investors of U.S. assets.
- In areas where there are no national security considerations, Chinese FDI has the potential to create jobs and economic growth.
- China has recently introduced a national security investment review mechanism similar to the Committee on Foreign Investment in the United States, although there are concerns among foreign companies that the Chinese government may use the mechanism to derail investment by foreigners in those companies and sectors it wants to remain under government control.

#### *Indigenous Innovation and Intellectual Property Rights*

- China's indigenous innovation policy is an outgrowth of the government's broad industrial policy and has been openly developed and documented through public plans and pronouncements, particularly the *National Medium- and Long-Term Plan for the Development of Science and Technology (2006–2020)*. The indigenous innovation policy seeks to nurture certain high-wage, high value-added industries designated by the government. Chinese firms are to be favored over foreign firms or China-based foreign affiliates in government procurement contracts. State-owned enterprises and municipal and provincial governments are also to show favoritism to Chinese domestic industries and businesses.

- Chinese officials, including President Hu, have pledged to modify China's indigenous innovation policy in response to protests from U.S. business leaders and top officials. Those promises have not been implemented at the local and provincial levels, however. China has a history of making promises and delivering little, particularly when doing as little as possible benefits the Chinese economy, as has been the case with China's promises to bring its intellectual property protections up to international standards and to cease requiring technology transfers from foreign firms.
- Foreign-invested enterprises seeking to be considered for government procurement contracts or public works projects are expected to file for patents and copyrights within China in order to qualify for preferential treatment in government contracting. Foreign affiliates risk the unintended transfer of their technology to Chinese firms if they do so, because of the nature of the Chinese intellectual property system and the lax enforcement of intellectual property laws and regulations in China.
- Although China agreed in 2001 to stop explicitly requiring foreign companies to surrender their technology to China in return for market access and investment opportunities, the government in Beijing still employs several tactics to coerce foreign firms to share trade secrets with Chinese competitors. China's industrial policy in general and its indigenous innovation policy in particular seek to circumvent accepted intellectual property protections and to extort technology from U.S. companies.
- In addition, the long effort by the central government to foster indigenous innovation is a message that will likely outlive any product catalogues. Restricting market access to domestic firms and requiring technology transfer as a cost for foreigners attempting to do business in China demonstrated the government's view that Chinese companies and governments are better off substituting domestic goods for imports.

*China's 12th Five-Year Plan and Technology Development and Transfers to China*

- One of the main objectives of the 12th Five-Year Plan is to redirect China's economy to one more focused on domestic consumption and less on exports and investment. The plan assumes that China's growth would therefore be more balanced and sustainable. The plan also emphasizes higher value-added production and increased government support for domestic high-tech industries.
- There is cause for skepticism about China's prospects for carrying out the rebalancing goals of the 12th Five-Year Plan. The Chinese government had similar goals in previous plans, but their implementation was sidelined in favor of pursuing higher export and investment growth.

- Increasing household consumption, a major goal of the 12th Five-Year Plan, and the subsequent emergence of a more assertive consumer class, may be in direct contradiction to the Chinese government's policy of keeping economic power firmly in the hands of the state and may compromise lending to many vested interests, including SOEs and the export sector.
- The 12th Five-Year Plan also advocates a move up the manufacturing value chain with the explicit mention of seven strategic emerging industries: New-generation information technology, high-end equipment manufacturing, advanced materials, alternative-fuel cars, energy conservation and environmental protection, alternative energy, and biotechnology. These industries, which will receive targeted government support, have the potential to be a source of economic growth and advanced innovation.
- Analysts and foreign business leaders fear that the emphasis on industrial upgrading will lead to the introduction of new government subsidies, which in turn will disadvantage foreign competitors.
- As part of its indigenous innovation policy, China incentivizes foreign companies to transfer technology in exchange for market access.
- Chinese government requirements that foreign corporations transfer technology to Chinese joint venture partners in exchange for market access violate written WTO prohibitions on forced technology transfers. The new requirements for technology transfer from foreign partners are often made in implicit rather than explicit terms, which may make challenging them in the WTO dispute procedure more difficult.

#### *China's Internal Dilemmas*

- The primary objective of the CCP is to remain in power. All other goals are intended to serve that end. As a consequence, the party has dedicated enormous resources to repress dissent before it becomes a destabilizing element and threatens the party's control.
- Despite the efforts of the party and the government to minimize dissent, citizen protest has been on the rise. Protests are sometimes brutally suppressed. The government will arrest and detain as a precautionary measure those it considers a threat to its control. The party and the government employ the news media to propagandize and mislead the public.
- The party is well aware of the dangers to its continuing authority posed by public rejection of a government that is unresponsive to the people. The party therefore reacts to citizen ire by attempting appeasement. This may take the form of authorizing the news media to highlight official abuses, particularly those committed by local officials. Still, corruption in all levels of government remains a problem for Beijing.

- Inflation has historically caused problems for the government in China. The rural poor and migrant workers are particularly disadvantaged by higher prices because they are so often reflected disproportionately in food and energy, which consume a larger portion of family expenses in rural areas. The government has responded to rising inflation with price controls and some curbs on bank lending. These tools are inadequate in the long run. China's policy of keeping the RMB undervalued in order to gain an export advantage removes a powerful anti-inflation tool from the central bank.
- Income and wealth inequality is a growing problem in China. One cause is the *hukou* system of residential registration, which was intended to limit the migration of the rural poor to the cities. This has created a large migrant population in China, moving from city to city to seek work in factories but unable to access healthcare and education services without the proper *hukou* designation for that area. This situation perpetuates poverty among the disadvantaged. Local officials favor it, because it limits their responsibility toward the migrant workers. A smaller group, known as the "ant tribe," consists of college graduates from second-tier schools in rural areas who also lack the *hukou* to live in urban areas but who nevertheless seek but are unable to find the jobs that they have trained for. This restive and disappointed population is a potential source of unrest.
- China's middle class has been considered by some to be a potential force for political reform. But the opposite is likely. As long as the party can deliver strong economic growth, particularly in urban areas, the middle class is likely to remain a force for stability.
- China's central government has reacted strongly to perceived challenges to its authority. It detains and imprisons dissidents. It censors the news and punishes journalists for infractions of its unwritten and arbitrary rules. China also attempts to control and censor the Internet and has had more success than most other authoritarian regimes in suppressing the flow of information among the public.

### **China's Activities Directly Affecting U.S. Security Interests**

China continues to demonstrate progress in its military modernization efforts. Of note, the People's Liberation Army (PLA) is acquiring specific means to counter U.S. military capabilities and exploit U.S. weaknesses. Since January 2011, China has conducted a flight test of its next-generation fighter aircraft, continued development of its antiship ballistic missile, and conducted a sea trial of its first aircraft carrier. These developments, when operational, will allow China to better project force throughout the region, including the far reaches of the South China Sea.

The PLA's military strategy is designed to provide the army with the means to defeat a technologically superior opponent, such as the U.S. military. As such, it focuses on controlling China's periphery, especially the western Pacific Ocean, degrading an opponent's technological advantages, and striking first in order to gain sur-

prise over an enemy in the event of a conflict. The Commission prefers to use the term “area control” for China’s regional strategy, because the terms “antiaccess” or “area denial” foster a U.S.-centric view that downplays the PLA’s ability to easily conduct operations against regional states. While U.S. bases in East Asia are vulnerable to PLA air and missile attacks, Japanese, Philippine, and Vietnamese bases are just as vulnerable, if not more so.

Tensions continued in 2011 between China and other claimants in the South China Sea territorial disputes as well as with Japan over territory in the East China Sea. Despite intermittent statements of cooperation, Chinese assertiveness in the South China Sea indicates that China is unlikely to concede its sovereignty claims. An implication of China’s growing assertiveness, especially its harassment and intimidation of foreign vessels, is the growing risk of escalation due to miscommunication and miscalculation. As chances of confrontation grow, so could the consequences for the United States, especially with regard to the Philippines, with which the United States holds a mutual defense treaty.

In 2011, as in previous years, the U.S. government, foreign governments, defense contractors, commercial entities, and various nongovernmental organizations experienced a substantial volume of actual and attempted network intrusions that appear to originate in China. Of concern to U.S. military operations, China has identified the U.S. military’s reliance on information systems as a significant vulnerability and seeks to use Chinese cyber capabilities to achieve strategic objectives and significantly degrade U.S. forces’ ability to operate.

The Commission’s *2011 Annual Report to Congress* investigates China’s advancing space program. China is now among the top few space powers in the world. China’s leadership views all space activities through the prism of comprehensive national power, using civil space activities to promote its legitimacy in the eyes of its people, to produce spin-off benefits for other industries, and for military-related activities. For example, China appears to be making great strides toward fielding regional reconnaissance-strike capabilities. China has also continued to develop its antisatellite capabilities, following up on its January 2007 demonstration that used a ballistic missile to destroy an obsolete Chinese weather satellite, creating thousands of pieces of space debris. As a result, in April 2011, astronauts evacuated the International Space Station out of concern of a possible collision with this debris. In addition, authoritative Chinese military writings advocate attacks on space-to-ground communications links and ground-based satellite control facilities in the event of a conflict. Such facilities may be vulnerable: in recent years, two U.S. government satellites have experienced interference apparently consistent with the cyber exploitation of their control facility.

## **Conclusions**

### *Military and Security Year in Review*

- Over the past year, China has demonstrated progress in modernizing the PLA. Recent developments confirm that the PLA seeks to improve its capacity to project force throughout the region.



- Continued improvements in China's civil aviation capabilities, as first noted in the Commission's 2010 Annual Report, enhance Chinese military aviation capabilities because of the close integration of China's commercial and military aviation sectors.
- In an effort to calm regional fears, China attempts to broadcast a benign image of its growing military capabilities. Official statements from Beijing over the past year describe China as a status quo power and downplay its military modernization efforts.
- In 2011, China continued a pattern of provocation in disputed areas of the South China Sea. China's policy in the region appears driven by a desire to intimidate rather than cooperate. Many of China's activities in the region may constitute violations of the *United Nations Convention on the Law of the Sea* and the *Declaration on the Conduct of Parties in the South China Sea*. While China sometimes demonstrates a willingness to cooperate with other claimants to disputed waters in the South China Sea, it is unlikely that China will concede any of its claims.
- China's government or military appeared to sponsor numerous computer network intrusions throughout 2011. Additional evidence also surfaced over the past year that the Chinese military engages in computer network attacks. These developments are consistent with the PLA's known missions and organizational features, as noted by the Commission's *2009 Annual Report to Congress* and contracted research study *Capability of the People's Republic of China to Conduct Cyber Warfare and Computer Network Exploitation*.
- China's military strategy envisions the use of computer network exploitation and attack against adversaries, including the United States. These efforts are likely to focus on operational systems, such as command, control, communications, computers, intelligence, surveillance, and reconnaissance assets. This could critically disrupt the U.S. military's ability to deploy and operate during a military contingency. Chinese cyber attacks against strategic targets, such as critical infrastructure, are also possible.

*China's "Area Control Military Strategy"*

- The PLA's military strategy is best described as an Area Control Strategy. At its core, this strategy seeks to provide guidance to the PLA on how to defeat a technologically superior opponent.
- In order to defeat a superior opponent, the Area Control Strategy emphasizes degrading an opponent's technological advantages; striking first in a conflict; and establishing military control over China's periphery, especially the maritime region off of China's eastern coast.

- Many of the PLA's force modernization efforts reflect China's Area Control Strategy. As a result, the PLA is acquiring capabilities that allow it to conduct surprise attacks aimed at degrading a superior military's advantages and preventing an opponent from effectively operating along China's periphery.
- Many of the PLA's evolving capabilities appear aimed at directly countering U.S. military capabilities or to exploit potential weaknesses in U.S. military operations. In addition, as the PLA expands its force projection capabilities, China's Area Control Strategy and supporting means will increasingly impact regional states. Finally, the heavy focus on offensive operations inherent in the PLA's Area Control Strategy could serve to undermine stability in the region.

*The Implications of China's Civil and Military Space Activities*

- China is one of the top space powers in the world today. The nation's capabilities, which are state of the art in some areas, follow from decades of substantial investment and high prioritization by China's top leaders. The prestige of space exploration and the national security benefits of space systems serve as primary motivators for Chinese decisionmakers.
- China views all space activities in the context of "comprehensive national power." This concept includes many dimensions, but military aspects are fundamental. The PLA's primacy in all of China's space programs, including nominally civil activities, illustrates this emphasis.
- China's civil space programs have made impressive achievements over the past several decades. If Chinese projections hold, these programs are poised for continued accomplishments over the next ten to 15 years, such as the development of a space laboratory and eventually a space station. As part of an active lunar exploration program, China may attempt to land a man on the moon by the mid-2020s.
- China seeks new opportunities to sell satellites as well as satellite and launch services in international commercial space markets. Chinese firms' prospects for greater success in this field remain uncertain over the near term. However, China's international space-related diplomatic initiatives and their firms' ability to offer flexible terms on sales to developing countries may provide additional opportunities.
- In the military sphere, China appears to seek "space supremacy." The PLA aims to implement this policy through two tracks. First, they increasingly utilize space for the purposes of force enhancement. The best example is China's integration of space-based sensors and guided weapons. Second, they seek the capabilities to deny an adversary the use of space in the event of a conflict. To this end, China has numerous, active, counterspace weapons programs with demonstrated capabilities. China's military space and counterspace activities are part of a larger strategy for area control.

### **China's Foreign Policy**

Despite Beijing's attempts to emphasize its peaceful rise, China continues to support countries that undermine international security. In particular, China's support for North Korea and Iran undermines international efforts to compel these countries to discontinue agendas and programs that destabilize their regions and undercut U.S. interests. As China's global interests expand in a complex international environment, Beijing has experienced a growing number of domestic actors, such as SOEs, interested in determining China's foreign policies. The plethora of new and emerging voices in China's foreign policy-making process makes it more challenging for foreign countries to interact effectively with China. In addition, the pluralization of China's foreign policy actors increases the chance of miscalculations when determining its foreign policies.

In a positive development, economic and diplomatic ties across the Taiwan Strait continue to improve; however, military relations between China and Taiwan lack progress. China maintains some 1,200 short-range ballistic missiles opposite Taiwan. U.S.-Taiwan relations were dominated this year by the question of whether the United States would approve Taiwan's separate requests for additional arms sales. Taiwan has requested three different sales: new F-16C/D fighter jets; upgrades for its current fleet of F-16A/B fighter jets; and diesel-electric submarines. In August 2011 the United States notified Congress of the sale of F-16A/B upgrades but not new F-16C/D fighter jets nor diesel-electric submarines. Reacting against the sale of any new military equipment, China has indicated that it may suspend some military-to-military engagements with the United States.

Some developments in Hong Kong over the past year suggest that Beijing's influence in the region's affairs is growing. During 2011, Beijing increased its focus on Hong Kong's economy, especially its role as a vehicle for the internationalization of China's currency. Mainland involvement in Hong Kong's political affairs was an issue of contention among Hong Kong policymakers and citizens throughout 2011. While Hong Kong citizens and press largely continue to enjoy freedom of expression and assembly, at times these rights were challenged by Hong Kong authorities, who were often perceived to be acting out of deference to Beijing.

### **Conclusions**

#### *An Overview of China's Relations with North Korea and Iran*

- China has continued over the past year to support North Korea despite North Korea's destabilizing actions. Diplomatically, China shields North Korea from pressure in international fora. China also continues to trade with and invest in North Korea, providing it with an economic lifeline in the face of growing international ostracism. Beijing's continued support for Pyongyang is primarily driven by its fear of a collapse of the North Korean regime and the consequences this would have for China's economic, social, and security interests, as well as the fear of the loss of a buffer state on its border.

- Despite U.S. efforts to sanction Iran for its support of international terrorism and pursuit of weapons of mass destruction, China remains a large investor in Iran's petroleum industry and a major provider of refined oil products. China may also be supplying Iran with advanced conventional weapons, such as cruise missiles. China's investments in Iran's petroleum industry, and its continued provision of gasoline and advanced conventional weapons, may be at odds with U.S. laws.
- Continued Chinese support for North Korea and Iran demonstrates China's willingness to place its national interests ahead of regional stability by providing economic and diplomatic support to countries that undermine international security.

#### *Actors in China's Foreign Policy*

- As China expands and diversifies its overseas activities, it encounters an increasingly complex environment requiring the input and advice from knowledgeable subject matter experts. As a result, China's foreign policy-making process is changing to accommodate input from actors who previously had little or no say.
- Actors with increasing influence on China's foreign policies include the PLA, large state-owned enterprises, and academics and think tanks. In addition, while still minor compared to other actors, public opinion, expressed primarily online, appears to have a modicum of influence on some Chinese foreign policies.
- The CCP remains firmly in control of China's foreign policies, especially for issues deemed critical, such as China's policies toward the United States, North Korea, and Taiwan. This is despite the increased difficulty Beijing may have in coordinating a coherent policy among a growing number of actors.
- The growing complexity of China's foreign policy-making process has mixed implications for the United States. On the one hand, Washington may find it more difficult to interact with priority counterparts in Beijing as the number of actors in the policy process expands. On the other hand, the plethora of Chinese actors may provide U.S. foreign policymakers with opportunities to understand or influence Beijing.

#### *Taiwan*

- In 2011, Taiwan and China have continued to strengthen their economic and diplomatic relations by focusing on implementing previous agreements rather than signing new agreements.
- A major factor leading to the slower pace of reduced tensions across the Taiwan Strait is Taiwan's upcoming presidential and legislative elections. Seeking to prevent improving cross-Strait ties from being used against the incumbent Kuomintang Party, both Taiwan and China have moved away from pressing for rapid negotiations and developments as in previous years.

- The cross-Strait military balance continues increasingly to favor China, making it less likely that a peaceful resolution to the Taiwan issue will occur. Despite attempts to improve its capacity to defend the island against a potential attack from the mainland, Taiwan continues publicly to call for additional U.S. arms sales to augment its defense needs.

#### *Hong Kong*

- Hong Kong plays a central role in China's policy goal of internationalizing its currency. In 2011, China introduced substantial new measures supporting Hong Kong's status as China's primary platform for RMB offshoring.
- Mainland involvement in Hong Kong's political affairs was evident in 2011, prompting citizen discontent and conflict within Hong Kong's democratic groups.
- Hong Kong continued to have a vibrant protest culture in 2011, with record amounts of participants in some annual protests. However, there were reports that police sometimes challenged Hong Kong citizens' rights during protests, especially when protests targeted mainland China.
- Hong Kong's mass media reported increased interference in their activities by Hong Kong authorities in 2011. Public perception of self-censorship in Hong Kong's press peaked in 2011, and public opinion of press credibility fell to its lowest level in eight years.

#### **China's Public Diplomacy Initiatives Regarding Foreign and National Security Policy**

The CCP treats the control of propaganda/public diplomacy messages to foreign audiences as a fundamental tool of statecraft. China is highly critical of what it calls the "western media's ideological assault on the rest of the world" and sees itself as engaged in a "global war for public opinion." In pursuit of a larger voice in international affairs, Chinese media officials have significantly increased resources for state-controlled foreign language news outlets. In addition, Chinese propaganda organs are actively engaged in influencing foreign officials and media. This is particularly concerning given the possibility that the People's Republic of China's official messages may not always reflect actual Chinese foreign policy goals.

#### ***Conclusions***

- The Chinese government places a high priority on the management of information as a tool of policy, to include the messages that it promotes to international audiences regarding its goals in foreign and national security policy. The central leadership of the Chinese Communist Party selects official foreign policy messages intended to support state policy goals. These messages are then disseminated through diplomatic channels, state-controlled media, advertising, and "track two" exchanges.

- The Chinese government’s official narratives stress China’s desire for mutually beneficial “peaceful development” and for a “harmonious” international environment that will allow China to focus attention and resources on its economic and social development. China’s statements on its defense policies emphasize that they are entirely defensive in nature and that China will never pose a threat to any of its neighbors.
- There are notable differences between the optimistic character of China’s official messages on national security policy, which stress prospects for international cooperation, and the nature of its domestic discourse, which portrays the United States as a dangerous and predatory “hegemon” of the international system.
- The Chinese government frequently discusses important policy issues in terms of China’s “core interests,” accompanied by an insistence that other countries accept the PRC’s non-negotiable positions on these issues. However, conflicting statements from different parts of the Chinese government leave it unclear as to exactly which issues fall into the category of a “core interest.” In order to prevent misunderstandings with the United States and other countries that could have serious diplomatic consequences, Beijing should clarify which issues it sees as truly representing a “core interest.”
- The emergence of a more outspoken field of PRC foreign policy actors has produced messages that are sometimes at variance with official government narratives. This is particularly true of nationalist voices within the Chinese military.
- The Chinese government makes extensive use of front organizations. Congress and the American public often are not aware that nominally private civic organizations in China that purport to have educational, cultural, or professional purposes are frequently controlled by military, intelligence, or Communist Party organs. These front organizations are used to advance PRC state interests while disguising the guiding role of the government.

### **THE COMMISSION’S KEY RECOMMENDATIONS**

The Commission believes that ten of its 43 recommendations to Congress are of particular significance. These are presented below in the order in which they appear in the Report. The complete list of 43 recommendations appears at the Report’s conclusion on page 355.

The Commission recommends that:

- Congress, through legislation, require the president to assign the National Security Council to conduct an agency-wide comprehensive review of the U.S. economic and security policies toward China to determine the need for changes to address the increasingly complicated and serious challenges posed by

China to U.S. international and domestic interests. Such a review should be examined and debated as appropriate by Congressional committees.

- Congress urge the administration to employ all necessary remedies authorized by WTO rules to counter the anticompetitive and trade-distorting effects of the Chinese government's extensive subsidies for Chinese companies operating in China and abroad.
- Congress direct the U.S. Department of Commerce to report annually on Chinese investment in the United States including, among other things, data on investment in the United States by Chinese SOEs and other state-affiliated entities.
- Congress direct the U.S. Securities and Exchange Commission to revise its protocols for reviewing filings by foreign entities listed on or seeking to be listed on the U.S. stock exchanges. The Securities and Exchange Commission should develop country-specific data to address unique country risks to assure that U.S. investors have sufficient information to make investment decisions. The commission should focus, in particular, on state-owned and -affiliated companies, and subsidies and pricing mechanisms that may have material bearing on the investment.
- Congress assess the reauthorization of Super 301 to assist in the identification of the policies and practices that China pursues that create the greatest impediment to U.S. exports entering the Chinese market and the most important policies or practices that unfairly or unjustifiably harm U.S. producers and workers in the U.S. market. Priority should be given to addressing such practices by the United States Trade Representative under such legislation.
- Congress direct the U.S. Government Accountability Office to undertake an evaluation of investments and operations of U.S. firms in the Chinese market and identify what federally supported R&D is being utilized in such facilities and the extent to which, and on what terms, such R&D has been shared with Chinese actors in the last ten years.
- Congress assess the adequacy of U.S. Department of Defense capabilities to conduct major operations in a degraded command, control, communications, computer, intelligence, surveillance, and reconnaissance environment for an extended period of time.
- Congress assess the adequacy and regularity of U.S. military exercises and training activities that simulate the destruction, denial, degradation, or manipulation of U.S. space assets. In addition, Congress should periodically evaluate whether the U.S. Department of Defense is taking sufficient measures to diversify its traditionally space-oriented capabilities, such as in navigation, communications, intelligence, surveillance, and reconnaissance.

- Congress investigate whether U.S. sanctions have been imposed on all Chinese firms that have violated the sanction laws by investing in Iran's petroleum industry or providing Iran with refined petroleum products or advanced conventional weapons.
- Congress urge the administration to sell Taiwan the additional fighter aircraft it needs to recapitalize its aging and retiring fleet.



## INTRODUCTION

This is the Commission's tenth year examining U.S.-China relations. During this time the United States has welcomed China's peaceful rise with the belief that by engaging China it would be encouraged to open up to the United States and the world, both economically and diplomatically, that it would expand freedom and human rights, and that it would become a responsible global stakeholder. For the last ten years the Commission has documented Chinese export subsidies; weapons proliferation; cyber attacks; non-compliance with World Trade Organization (WTO) obligations; forced technology transfers; military modernization; resource acquisition strategies; expansion of Chinese foreign policy interests; the Chinese military threat to Taiwan; espionage; and information control, among other issues. While China has taken some steps to engage the international community, by and large the Communist Party of China (CCP) has continued to steer policy in its own narrow self-interest at home and abroad, often without regard for international rules and norms. As a result, worldwide concern about China is growing as more people see the implications of the rise of a powerful authoritarian state.

In 2011, China assumed a more assertive role on the global stage. China's new posture was reflected in an aggressive trade agenda, a push for a larger role in international institutions, and provocative moves in the South and East China Seas. These actions were both a reflection and a consequence of China's growing economic prominence and resource needs, as well as China's view that the United States is in decline while China is ascendant. Chinese policies have had an impact on the United States, ranging from a negative effect on the U.S. economy to increased pressure from some parts of the international community for the United States to ensure the security of the global commons.

Last year, the Commission highlighted China's backsliding from market reforms in favor of an increased role of the state in the economy. In contrast to the general trend of economic liberalization over the last three decades, last year's pattern of increased state dominance continued in 2011. China subsidizes its state-owned enterprises to the detriment of both private Chinese firms and international competitors. Nevertheless, Chinese leaders acknowledge the economy must be moved away from its investment-led, export-driven growth model toward one more dependent on domestic consumption.

Even when China makes a commitment to economic reform, the government reverts to its historical pattern of inadequate implementation. President Hu Jintao and other Chinese officials responded to western pressure in January 2011, promising to ease a policy of discriminating against foreign companies in government

procurement decisions; however, real change remains elusive, particularly among the provincial and local governments.

In March 2011, China approved its 12th Five-Year Plan (2011–2015), which calls for the transformation of the Chinese economy into a high-technology and innovation-oriented juggernaut. The plan identifies seven strategic emerging industries in which the Chinese hope to become world leaders. While the desire to move up the manufacturing value chain is a common goal among nations, the web of Chinese industrial policies used to achieve this objective has often had a detrimental impact on U.S. interests and is often inconsistent with China's obligations under the WTO. Practices such as forced technology transfer and the creation of joint venture companies as a condition to obtaining access to the Chinese market; the adoption of unique, Chinese-specific standards for high-tech equipment; and extensive intellectual property rights violations are among the faulty policies designed to help China achieve its goal of becoming a high-tech leader.

China's military modernization, combined with the unclear nature of Beijing's views of what constitutes an attack and the People's Liberation Army's military doctrine that emphasizes striking first in a conflict, increases the possibility for inadvertent conflict in the region. China's massive military modernization includes the sea test of its first aircraft carrier, the introduction of a fifth-generation stealth fighter, and the further development of already sophisticated cyber warfare and counterspace capabilities. Designed to defeat a technologically superior opponent, China's military strategy emphasizes striking first and controlling the nation's periphery in the event of a conflict. While the exact pace and scale of China's military modernization effort and the intentions behind it remain opaque to the outside world, it is clear that China is acquiring specific means intended to counter U.S. military capabilities and exploit U.S. weaknesses.

While China has taken an externally assertive posture, it faces many internal challenges. The CCP relies on economic growth, combined with strict authoritarian rule, to maintain control over a factious and geographically vast nation. Sharp increases in consumer prices, a pivotal factor in the early days of the student protests in Tiananmen Square in 1989, are once again a problem for the Chinese economy. While the party is particularly concerned about inflation, it also struggles to respond to other causes of protest such as corruption, pollution, and income inequality. The CCP faces the dilemma that the very authoritarian measures it uses to assert control of the Chinese people result in abuse, corruption, and policies that increase popular dissatisfaction. In turn, China's domestic instability may be fueling its external assertiveness if Chinese leaders bend to or encourage nationalist sentiment.

Secretary of State Hillary Rodham Clinton observed that China represents one of the most challenging and consequential bilateral relationships the United States has had to manage. While promoting messages of reassurance to the international community, China focuses on pursuing its own narrow interests. Despite the threatening and unpredictable conduct of North Korea, the CCP appears to have calculated that its interests are better served by the support of the regime than by its removal. Likewise, China's

relationship with Iran undermines international efforts to curtail Iran's pursuit of weapons of mass destruction and support of international terrorism.

Despite the improvement in economic and diplomatic relations across the Taiwan Strait, China deploys some 1,200 short-range ballistic missiles against the island. In response to the U.S. sale to Taiwan of a new \$5.8 billion package of upgrades to its aging fleet of F-16 fighter jets, China indicated that it may suspend a series of military-to-military engagements. To the consternation of its neighbors, China asserts its expansive territorial claims in the South and East China Seas. China is increasingly capable of pursuing its own interests at the expense of regional, perhaps even global, stability.

China's opaque intentions complicate our understanding and response to its rise as a world power. China's stated desire to maintain stable and peaceful international relationships conflicts with such actions as harassing vessels operating in international waters off the Chinese coast, aggressively pressing unrecognized territorial claims in the East and South China Seas, and supporting North Korea in the aftermath of unprovoked acts of aggression against South Korea. In fact, the People's Republic of China's official messages may be a cover for China's actual foreign policy goals. In addition, internal power struggles among Chinese foreign policy-makers make it difficult to understand the decision-making process in China, increasing the chance of miscalculating China's foreign policy.

The next few years will illustrate how China wishes to embrace the international order and the manner in which it will use its increasing power. China is faced with a choice. It can either join the community of nations in the existing international order based on the rule of law, or it can aggressively assert its own interests without regard for the concerns of other states and face growing opposition from the global community. The latter is not in anyone's interest. By welcoming China into the WTO and other international bodies, the U.S. government has demonstrated that it wants the Chinese government to be a responsible international stakeholder; however, until China more fully complies with international norms, the United States must be more forceful in asserting its own national interests. Insisting on reciprocity in our economic relationship and respect for international laws and norms in our geostrategic relationship is a start. This would not only benefit U.S. citizens but also demonstrate to the world that the United States is still the standard-bearer for stability and rule of law. We are in a global competition with China, and U.S. policies should flow from this premise. The United States should insist on reciprocity and mutual benefit as guiding principles of the U.S.-China relationship. It is clear that China will pursue its own narrow goals unless international pressure is brought to bear to modify any objectionable behavior.

While effectively responding to China is not an easy task, the Commission's 2011 Report is an outline that we believe will be helpful to Congress in addressing China's rise. The Commission recommends that Congress, through legislation, require the president to assign the National Security Council to conduct an agency-

wide comprehensive review of U.S. economic and security policies toward China to determine the need for changes to address the increasingly complicated and serious challenges posed by China to U.S. international and domestic interests. Such a review should be examined and debated as appropriate by Congressional committees.

# CHAPTER 3

## CHINA'S FOREIGN POLICY

### SECTION 1: AN OVERVIEW OF CHINA'S RELATIONS WITH NORTH KOREA AND IRAN

#### **Introduction**

Despite Beijing's stated claim to be a responsible major power, China continues to place its national interests ahead of regional stability by providing economic and diplomatic support to countries that undermine international security. In particular, China continues to have strong relations with two countries that have the most potential to destabilize their regions of the world, North Korea and Iran. Despite Pyongyang's growing isolation as the result of its recent provocative actions, Beijing continues to defend its long-time ally and provide it with much-needed economic support. China also continues to invest in and trade with Iran, despite Iran's support for international terrorism and pursuit of weapons of mass destruction. China's support for these regimes provides the two countries with resources that could be used to defy international sanctions and threaten the stability of the region. This section of the Annual Report provides an overview of China's relations with these nations in recent years.

#### **China's Support for North Korea**

Over the past year and a half, the Democratic People's Republic of Korea (or North Korea) has acted in a destabilizing fashion, increasing the chances for conflict on the Korean Peninsula. In 2010, North Korea attacked and sank a South Korean naval vessel, revealed a previously unknown uranium enrichment facility, and shelled a South Korean island. In response, most of the international community increasingly distanced itself economically and diplomatically from North Korea. China, however, has taken a different approach and instead continues to support its neighbor and ally, all the while refusing to criticize publicly the North for its actions.\* China's continued support for North Korea reflects Beijing's

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\*It should be noted that in the past, China has pressured North Korea behind the scenes to refrain from overly destabilizing activities. For example, in 2006, media reports claimed that China shipped no oil to North Korea for an entire month. Although there was no formal announcement that China's action was an attempt to pressure North Korea, the embargo did occur one month after North Korea's October 2006 nuclear test. Although one Japanese expert claimed China cut off oil supplies to North Korea after North Korea shelled a South Korean island, Commission staff were unable to discover any confirmation of the oil embargo. Furthermore, a review of China's exports to North Korea showed that while China's oil exports to North Korea did drop in the third and fourth quarter of 2010, the decline is similar to previous declines in China's oil exports to North Korea in the latter half of 2006 through 2009. Joseph Kahn, "China

Continued

desire to prevent the collapse of the North Korean regime and the negative impact this could have on China's economic and social stability. As a result, China is of its own volition in a "mutual hostage situation" where it feels forced to continue to support North Korea despite, and increasingly due to, the North's destabilizing activities.

### ***China's diplomatic support for North Korea***

Throughout 2010 and into 2011, China continued to support and defend North Korea against international pressure despite North Korean activities that had the potential to cause a war in North-east Asia. After North Korea torpedoed a South Korean naval vessel in March 2010, killing 46 sailors,\* China refrained from condemning the attack or implicating North Korean involvement.<sup>1</sup> Instead, China waited a month to respond publicly to the sinking, at which time China simply referred to the incident as a "tragedy."<sup>2</sup> When a multinational report concluded a few months later that North Korea was indeed responsible, China refused to accept the findings and instead continued to call the incident a "mysterious naval tragedy."<sup>3</sup> Beijing also used its position as a member of the United Nations (UN) Security Council to dilute a UN statement that would have condemned North Korea for the attack.<sup>4</sup> †

In late 2010, China again defended North Korea from international criticism despite the North's provocative actions. On November 20, 2010, Pyongyang revealed a previously unknown nuclear enrichment facility, developed in defiance of UN sanctions.‡ In response to the revelation, Chinese Foreign Ministry Spokes-

cut off exports of oil to North Korea—Asia—Pacific—International Herald Tribune," *New York Times*, October 30, 2006. <http://www.nytimes.com/2006/10/30/world/asia/30iht-oil.3334398.html>; Sunny Lee, "China cut off oil to stop N. Korea from retaliating against South," *Korea Times*, January 19, 2011. [http://www.koreatimes.co.kr/www/news/nation/2011/01/113\\_79966.html](http://www.koreatimes.co.kr/www/news/nation/2011/01/113_79966.html); and International Trade Centre, "Trade Map" (Geneva, Switzerland: September 30, 2011). [http://www.trademap.org/light/Bilateral\\_TS.aspx](http://www.trademap.org/light/Bilateral_TS.aspx).

\* On March 26, 2010, North Korea torpedoed a South Korean corvette, the *Cheonan*, killing 46 sailors. Although not immediately identified as the perpetrator of the attack, a North Korean minisubmarine was implicated as the attacker by a multinational study released a few months later. International Crisis Group, "China and Inter-Korean Clashes in the Yellow Sea," *Asia Report 200* (Brussels, Belgium: January 21, 2011): 2–5.

† Beijing did protest loudly, however, when the United States and South Korea announced joint naval exercises, partially in response to North Korea's sinking of the *Cheonan*. Reacting to these exercises, China's Ministry of Foreign Affairs stated that "we firmly oppose foreign warships and military aircraft carrying out activities in the Yellow Sea and other Chinese coastal waters that affect China's security interests." China also subsequently held its own military exercises in the Yellow, East China, and South China seas. International Crisis Group, "China and Inter-Korean Clashes in the Yellow Sea," *Asia Report 200* (Brussels, Belgium: January 21, 2011): 1; Qin Gang, spokesperson for the Chinese Ministry of Foreign Affairs, July 9, 2010, cited in Bonnie Glaser and Brittany Billingsley, "US–China Relations: Tensions Rise and Fall, Once Again," *Comparative Connections* 12:3 (October 2010); and Chris Buckley, "China denies military exercise aimed at U.S.," Reuters, June 29, 2010. <http://www.reuters.com/article/2010/06/29/us-china-military-idUSTRE65S1YU20100629>.

‡ On November 20, 2010, North Korea surprised the international community by revealing a previously unknown uranium enrichment facility at the Yongbyon Nuclear Complex. According to North Korean engineers, this facility produces low enriched uranium for fuel in a still-under-construction nuclear power reactor. However, Sigfried S. Hecker, codirector of Stanford University's Center for International Security and Cooperation and the first outsider invited to visit the facility, stated that the facility could produce either fuel for the nuclear reactor or, with modifications, weapons-grade uranium. Both the newly revealed facility and the future nuclear power reactor violate UN sanctions. Siegfried S. Hecker, "A Return Trip to North Korea's Yongbyon Nuclear Complex" (Stanford, CA: Stanford University, Center for International Security and Cooperation, November 20, 2010), p. 1. <http://iis-db.stanford.edu/pubs/23035/HeckerYongbyon.pdf>; International Crisis Group, "China and Inter-Korean Clashes in the Yellow Sea," *Asia Report 200* (Brussels, Belgium: January 21, 2011): 11; and David E. Sanger, "North Koreans Unveil New Plant for Nuclear Use," *New York Times*, November 20, 2011. <http://www.nytimes.com/2010/11/21/world/asia/21intel.html>.

woman Jiang Yu simply expressed “that all sides should exercise calm and restraint, and maintain a responsible attitude to prevent tensions from escalating, playing a positive role in preserving the peace and stability of the peninsula.”<sup>5</sup> China’s first official statement expressing concern over North Korea’s new enrichment facility occurred two months later, during Chinese President and Communist Party Secretary Hu Jintao’s January 2011 visit to the United States. The joint statement from that visit noted that “the United States and China expressed concern regarding the DPRK’s [North Korea’s] claimed uranium enrichment program.”<sup>6</sup> Despite this statement, in the following month China maneuvered within the UN Security Council to block an expert report about the revelation of the new facility.<sup>7</sup> Less than a week after revealing the nuclear enrichment facility, China again blocked international pressure on North Korea when the North Korean military shelled a South Korean island, killing four South Koreans.\* Following the attack, China declined to criticize the North publicly and instead called for “emergency talks” between North Korea and South Korea.<sup>8</sup> China also maneuvered within the UN Security Council to successfully block a statement condemning the shelling.<sup>9</sup>

China has also sought to protect North Korea in light of its continued proliferation attempts over the past year. Over the course of the past year, several accounts of North Korean attempts to defy international sanctions have come to light. According to a 2010 report from an expert panel established by the United Nations, North Korea may be involved in “nuclear and ballistic missile related activities in certain countries including Iran, Syria and Myanmar.”<sup>10</sup> *The New York Times* reported that in defiance of UN Security Council Resolution 1874 North Korea smuggled, possibly through China, at least 19 intermediate-range ballistic missiles to Iran.<sup>11</sup> However, when the United Nations established an expert panel to investigate North Korea’s continued attempts to proliferate weapons of mass destruction, Beijing lobbied to delay the report’s release.<sup>12</sup> Ultimately unsuccessful, Beijing then switched tactics and attacked the authority of the report itself, stating that “[t]his does not represent the position of the Security Council, and nor [sic] does it represent the position of the relevant Security Council sanctions committee.”<sup>13</sup>

Besides defending North Korea against international pressure, Beijing also has sought publicly to portray its relationship with North Korea as strong and getting stronger. According to experts Scott Snyder, director of the Center for U.S.-Korea Policy at the Asia Foundation, and See-won Byun, a research associate at the same institute:

\* On November 23, 2010, the North Korean military shelled South Korea’s Yeonpyeong Island, killing two South Korean civilians and two South Korean marines. This was the first artillery attack on South Korean territory since the end of the Korean War in 1953. On August 10, 2011, North Korea again fired live artillery rounds into South Korea, this time in the maritime territory around the same island. John M. Ghionna and Jung-yoon Choi, “North, South Korea Exchange Fire Along Tense Western Sea Border,” *LA Times*, August 10, 2011. <http://articles.latimes.com/2011/aug/10/world/la-fgw-koreas-exchange-fire-20110810>; and Peter Foster, “North Korean attack on Yeonpyeong Island is worst against civilians in 20 years,” *Telegraph* (United Kingdom), November 23, 2010. <http://www.telegraph.co.uk/news/worldnews/asia/southkorea/8153100/North-Korean-attack-on-Yeonpyeong-Island-is-worst-against-civilians-in-20-years.html>.

*China and North Korea took unprecedented steps to consolidate political ties through historic high-level party and military exchanges in October [2010] commemorating the 65th anniversary of the founding of the WPK [the Workers Party of Korea, North Korea's Communist Party] and the 60th anniversary of the entry of the Chinese People's Volunteers (CPV) into the Korean War.*<sup>14</sup>

During the 65th anniversary of the founding of North Korea's Communist Party, Zhou Yongkang, a member of the Standing Committee of the Politburo, led a delegation to China to meet North Korean leader Kim Jong Il.<sup>15</sup> Later that same month, President Hu and Chinese Vice President (and likely future President and Communist Party leader) Xi Jinping celebrated the 60th anniversary of China's entry into the Korean War, noting that "[t]he Chinese people will never forget the friendship—established in battle—with the DPRK's [North Korea] people and army."<sup>16</sup> In July 2011, at the 50th anniversary of the signing of the *Treaty of Friendship, Cooperation and Mutual Assistance between China and North Korea*, President Hu noted that "[i]t is the firm and unwavering strategic policy of the Chinese Party and Government to continue to strengthen and develop the traditional China-DPRK [North Korea] friendly and cooperative relations [and] boost high-level visits and exchanges and expand economic cooperation."<sup>17</sup>

Further demonstrating the heightened relationship despite North Korea's provocative activities is the number of high-level meetings between the two countries. For example, since May 2010, Kim Jong Il has made an unprecedented four trips to China.\* In addition, the past year has seen a large number of exchanges between the Chinese and the North Korean governments. Table 1, below, lists some of the major exchanges.

**Table 1: Timeline of Sino-North Korean Diplomatic Exchanges since the Attack on the *Cheonan***

Date	Event
Mar. 30–Apr. 3, 2010	An Yonggi, director of the North Korean military's Foreign Affairs Department, visits Beijing and meets with Xu Caihou, vice chairman of the People's Republic of China (PRC) Central Military Commission
Apr. 29–May 1, 2010	Kim Yong Nam, North Korean legislator and president of the Presidium of the Supreme People's Assembly, visits Shanghai for the World Expo and meets with PRC President Hu Jintao
Aug. 16–18, 2010	Wu Dawei, PRC envoy on Korean Peninsula Affairs, visits North Korea and meets Kim Jong Il and Foreign Minister Pak Ui-chun

\*Mr. Kim's trips to China occurred in May and August 2010 and in May and August 2011. See Se Young Lee, "China Confirms Visit by North Korea's Kim," *Wall Street Journal*, May 22, 2011. <http://online.wsj.com/article/SB10001424052702304520804576339052444645420.html>; Evan Ramstad, "China, North Korea Tout Ties as Kim Exits," *Wall Street Journal*, August 30, 2010. <http://online.wsj.com/article/SB10001424052748703369704575461162930482200.html>; *Chosun Ilbo* (South Korea), "Cracks Open in N. Korea-China Ties," June 7, 2011. [http://english.chosun.com/site/data/html\\_dir/2011/06/07/2011060701031.html](http://english.chosun.com/site/data/html_dir/2011/06/07/2011060701031.html); and Mansur Mirovalev, "Kim Jong Il, North Korea Leader, Visits China," Associated Press, August 25, 2011. [http://www.huffingtonpost.com/2011/08/25/kim-jong-il-china\\_n\\_936054.html](http://www.huffingtonpost.com/2011/08/25/kim-jong-il-china_n_936054.html).



**Table 1: Timeline of Sino-North Korean Diplomatic Exchanges since the Attack on the *Cheonan*—Continued**

Date	Event
Sept. 30–Oct. 2, 2010	Choe Thae Bok, secretary of the Worker's Party of Korea Central Committee and chairman of the Supreme People's Assembly, leads delegation to China and meets with PRC President Hu Jintao
Oct. 9–11, 2010	Zhou Yongkang, member of the Chinese Communist Party's (CCP) Standing Committee, leads a delegation to North Korea and meets with Kim Jong Il
Oct. 14, 2010	Pyon In Son, vice minister of North Korea's People's Armed Forces, leads a military delegation to Beijing and meets with PRC Defense Minister General Liang Guanglie
Oct. 25, 2010	General Guo Boxiang, PRC vice chairman of the Central Military Commission, visits Pyongyang and meets with North Korean Premier Choe Yong-rim
Nov. 30–Dec. 4, 2010	Choe Tae Bok, chairman of the Supreme People's Assembly, visits Beijing and Jilin and holds talks with PRC State Councilors Wu Bangguo and Chen Zhili
Dec. 8–9, 2010	Dai Bingguo, PRC vice minister of foreign affairs, visits North Korea and meets with Kim Jong Il
Feb. 13–14, 2011	Meng Jianzhu, PRC state councilor and minister of Public Security, visits North Korea and meets with Kim Jong Il
Apr. 12, 2011	Zhang Mingqi, vice president of the All-China Federation of Trade Unions, visits North Korea and meets with Choe Ryong Hae, secretary of the Central Committee of the Worker's Party of Korea
Apr. 13, 2011	North Korea's first vice foreign minister, Kim Kye Gwan, visits China and meets with PRC Vice Foreign Minister Zhang Zhijun, Foreign Minister Yang Jiechi, and Special Representative for Korean Peninsula Affairs Wu Dawei
May 16–20, 2011	A delegation of the Chinese People's Political Consultative Conference (CPPCC) led by Chen Zongxing, vice chairman of the CPPCC National Committee, visits North Korea and meets Kim Yong Nam, president of the Presidium of the Supreme People's Assembly
June 9, 2011	Chen Deming, PRC minister of Commerce, visits North Korea and meets with Jang Song Taek, vice chairman of the DPRK National Defense Commission
June 10–14, 2011	A delegation led by Li Yuanchao, head of the CCP Organization Department, visits North Korea for a "strategic dialogue" with DPRK counterparts, meeting Kim Yong Nam, president of the Presidium of the Supreme People's National Assembly; Choe Thae Bok, chairman of the Supreme People's Assembly; and Kim Jong Il
June 24–28, 2011	Chen Zhenggao, deputy secretary of the Liaoning Provincial Party Committee and governor of Liaoning Province, leads a delegation to North Korea and meets North Korean Premier Choe Yong Rim in Pyongyang
July 9–12, 2011	Yang Hyong Sop, vice president of the Presidium of North Korea's Supreme People's Assembly, leads a delegation to China and attends a reception on July 10 hosted by Ji Jae Ryong, North Korea's ambassador to China, and attended by PRC State Councilor Dai Binguo

**Table 1: Timeline of Sino-North Korean Diplomatic Exchanges since the Attack on the *Cheonan*—Continued**

Date	Event
July 11–14, 2011	Zheng Dejiang, PRC politburo member and vice premier, travels to North Korea in celebration of the 50th anniversary of the Sino-North Korean mutual assistance treaty
July 9–12, 2011	Yang Hyong Sop, vice president of the Presidium of North Korea's Supreme People's Assembly, leads a delegation to China and attends a reception on July 10 hosted by Ji Jae Ryong, North Korea's ambassador to China, and attended by PRC State Councilor Dai Binguo
July 22, 2011	Foreign Minister Yang Jiechi and North Korean counterpart Pak Ui Chun hold talks on the sidelines of the Asian Regional Forum in Bali. The PRC Foreign Ministry spokesperson expresses support for bilateral talks held on the sidelines between ROK (South Korea) and North Korean envoys of the Six-Party Talks Wi Sung-lac and Ri Yong-ho
Aug. 4–7, 2011	Chinese Navy fleet visits Wonsan, North Korea, where Vice Admiral Tian Zong, commander of China's northern fleet, is received by North Korean Rear Admiral Kim Myong Sik
Aug. 25–26, 2011	Jon Chang Bok, chief of the General Logistics Bureau of the Korean People's Army Armed Forces Department, leads a Korean People's Army delegation to China and meets Liao Xilong, chief of the PLA General Logistics Department, and Defense Minister Liang Guanglie

Sources: Scott Snyder and See-won Byun, "China-Korea Relations," *Comparative Connections* 12: 4 (Honolulu, HI: January 2011): 112–16; Scott Snyder and See-won Byun, "China-Korea Relations," *Comparative Connections* 13: 1 (Honolulu, HI: May 2011): 116–18; and Scott Snyder and See-won Byun, "China-Korea Relations: A Fragile China-ROK [Republic of Korea, or South Korea] Strategic Partnership," *Comparative Connections* 13: 2 (Honolulu, HI: September 2011): 106–10.

### ***China's economic support for North Korea***

In addition to diplomatic support, Beijing also continues to provide Pyongyang with economic support that North Korea increasingly needs due to its growing international isolation. As the Congressional Research Service noted, "China, with its huge economy and rapid rate of growth, is the lifeline that keeps [North Korea] alive."<sup>18</sup> Drew Thompson, former director of China Studies at the Center for the National Interest, wrote that:

*Chinese aid, trade, and investment are critical to North Korea's social stability and economic productivity and a key source of technology and hard currency. Presumably, without this trade and investment, Kim Jong Il would lack the means to secure the allegiance of elites that support his rule, making trade and investment with China particularly important for ensuring the regime's survival.*<sup>19</sup>

China is North Korea's largest trading partner.\*<sup>20</sup> Although accurate trade values for Sino-North Korean trade are unavailable,

\* In 2010, the top five importers of North Korean goods were (in order): China, South Korea, Egypt, South Africa, and the Russian Federation. The top five exporters to North Korea in 2010 were China, South Korea, Brazil, the Netherlands, and Egypt. International Trade Centre, "Trade Map" (Geneva, Switzerland: August 12, 2011). <http://www.trademap.org/light/Bilat->

international data estimate bilateral trade between China and North Korea in 2010 reached \$3.46 billion, an increase of 29 percent over 2009.<sup>21</sup> In 2010, China exported to North Korea \$2.3 billion worth of goods and imported \$1.2 billion. China's top five imports from the North in 2010 included coal (33 percent of total imports); mineral ores (21 percent of total imports); apparels (14 percent of total imports); finished iron and steel (9 percent of total imports); and fish and seafood products (5 percent of total imports).<sup>22</sup> China's primary exports to North Korea in 2010 were mineral fuels and oils (21 percent of total exports), followed by machinery (11 percent of total exports); electronics (8 percent of total exports); vehicles (7 percent of total exports); and plastics (4 percent of total exports).<sup>23</sup>

Despite the large trade deficit with China, North Korea gains more from the trade, since it is desperately dependent upon Chinese imports. In 2010, 52 percent of North Korea's imports came from China, more than double the amount imported from South Korea, the North's second-largest import source.<sup>24</sup> Jayshree Bajoria, a senior staff writer at the Council on Foreign Relations, estimated that China may provide an estimated 90 percent of North Korea's energy, 80 percent of its consumer goods, and 40 to 45 percent of its food.<sup>25</sup> In contrast, bilateral trade with North Korea constituted less than 0.2 percent of China's 2010 total global trade.<sup>26</sup> North Korea's dependency on China likely has increased over the past year, since South Korea, the North's other main trade partner, began curtailing trade with the North after last year's sinking of the *Cheonan*.<sup>27</sup> In May 2010, South Korea took the unprecedented step of banning all inter-Korean trade, except for items produced at North Korea's Kaesong Industrial Complex, a North Korean-South Korean joint industrial park. As a result of the partial ban, inter-Korean trade, from imposition of the ban to May 2011, decreased by 54 percent, down to \$118 million (excluding Kaesong Industrial Complex trade).\*

China also provides North Korea with much-needed foreign direct investment. China's investments in North Korea are concentrated in a few sectors. According to the Open Source Center, 43 percent of publicly listed Chinese-North Korean joint ventures were involved in some facet of natural resource production.<sup>28</sup> The two countries have established three joint special economic zones, all located in North Korea near the border with China.<sup>†</sup><sup>29</sup> Chinese entities have also pledged to invest in several infrastructure projects. China's Shangdi Guanqun Investment Company, for example, is renovating North Korea's Rason port.<sup>30</sup> Of note, the announcement of the port project came just one month after North Korea's shelling of Yeonpyeong Island and the revelation of a sec-

eral TS.aspx; and United Nations, "United Nations Commodity Trade Statistics Database." <http://comtrade.un.org/db/>.

\*Of import, trade through the Kaesong Industrial Complex actually grew for the same period, reaching \$1.44 billion in 2010, a growth of \$103 million (54 percent) over 2009. Evan Ramstad, "Strong Kaesong Boosts Inter-Korean Trade," *Wall Street Journal*, May 27, 2011. <http://blogs.wsj.com/korearealtime/2011/05/27/strong-kaesong-boosts-inter-korean-trade/>.

†The zones are in the North Korean cities of Rason and Sinuiju and on the North Korean islands of Hwanggu'mp'yo'ng and Wihwa. Xinhua, "China, DPRK [Democratic People's Republic of Korea] to develop two economic zones," June 9, 2011. [http://www1.chinadaily.com.cn/china/2011-06/09/content\\_12667570.htm](http://www1.chinadaily.com.cn/china/2011-06/09/content_12667570.htm); and Jay Solomon and Jeremy Page, "Chinese Firm to Invest in North Korea," *Wall Street Journal*, January 19, 2011. <http://online.wsj.com/article/SB10001424052748704678004576090270026745368.html>.

ond uranium enrichment facility. Undisclosed Chinese companies are also investing in the construction of a highway from the port to the border with China and building a new bridge over the Yalu River, which separates China from North Korea.<sup>31</sup> Other Chinese joint venture investments include mineral and metal extraction and processing and low-end manufacturing facilities.<sup>32</sup>

Unlike in many other countries where China invests, the majority of Chinese investors operating in North Korea are not national state-owned enterprises but rather “privately owned companies and provincial, prefecture, and municipal-owned [state-owned enterprises],” according to Mr. Thompson.<sup>33</sup> Only four out of 138 known Chinese companies engaging in joint ventures in North Korea were national-level state-owned enterprises, and only two of the companies rank among China’s top 100.<sup>34</sup> According to an Open Source Center report, of 86 Chinese joint ventures in North Korea, approximately 65 percent originated from China’s northeastern provinces Heilongjiang, Liaoning, and Jilin, which border North Korea.<sup>35</sup> Explanations for the apparent lack of national-level investments are not clear, but it may provide China’s northeast provinces with some influence over China’s foreign policy (see sec. 2 of this chapter for more on provinces as foreign policy actors).

Unfortunately, accurate data on the amount of China’s investments in North Korea are unavailable. According to China’s Ministry of Commerce, China’s officially reported 2010 investments in North Korea totaled \$12.1 million, a 52 percent increase over 2009. China’s total investment in North Korea since 2004 equaled \$109.3 million.<sup>36</sup> Yet recent activities by China cast doubt upon these statistics or point to a recent radical uptick in investments. For example, a Chinese Foreign Ministry spokesperson stated that total investment in one of the special economic zones will be between \$300 million and \$500 million.<sup>37</sup> China’s funding for the Yalu bridge project is estimated at \$260 million.<sup>38</sup> The *Wall Street Journal* reported that China’s investment in the Rason port project is estimated at \$2 billion.<sup>39</sup> If the estimate is accurate, and the project is seen to completion, this will be China’s single largest investment in North Korea and nearly 20 times the size of China’s claimed 2004 to 2009 total investments in North Korea.

Although precise data are unavailable, China’s foreign direct investment in North Korea is substantial and provides the North with vital resources. Currently, excluding South Korea’s investment in the Kaesong Industrial Complex, China is North Korea’s largest foreign direct investor.<sup>40</sup> While figures for 2009 and 2010 are unknown, estimates indicate that in 2008 China provided 94 percent of all investments in North Korea.<sup>41</sup> \* Furthermore, while many nations are decreasing their investments in North Korea on account of its recent provocations,<sup>42</sup> China appears to be increasing its investment in North Korea as the large high-profile projects detailed above demonstrate.

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\* By way of comparison, North Korea only receives a miniscule portion of China’s overall foreign direct investments: only .02 percent in 2010, according to China’s official statistics. Ministry of Commerce, People’s Republic of China, “2010 Niandu Zhongguo Duiwai Zhijie Touzi Tongji Gongbao” (Statistical Bulletin on China’s Outward Direct Investment, 2010) (Beijing, China: 2011), p. 82.

China also provides economic support to North Korea by only loosely implementing international sanctions against North Korea. According to a Congressional Research Service study, despite China's publicly strong support for UN sanctions against North Korea for its nuclear program, China takes a "minimalist approach" to enforcing those sanctions. The study continues, noting that China persists in allowing North Korea trade and financial transactions to transit Chinese territory without rigorous inspections, contrary to UN sanctions.<sup>43</sup> According to media reports, China has also been complicit in allowing North Korea's continued support of Iran's nuclear program by permitting cargo to transit through China unchecked and failing to act on U.S.-provided intelligence toward this end.<sup>44</sup> In addition, China continues to allow luxury goods, banned by UN sanctions, to flow unobstructed to North Korea.<sup>45</sup>

#### **UN Sanctions against North Korea**

Currently, the United Nations has two main sets of reinforcing sanctions against North Korea for Pyongyang's illicit weapons of mass destruction programs: UN Security Council Resolution 1718 and UN Security Council Resolution 1874.

*UN Security Council Resolution 1718*: passed in 2006 in response to North Korea's October 9, 2006, nuclear weapons test. This resolution called upon member states to refrain from purchasing or transferring to, or procuring from, North Korea large military platforms (such as tanks and aircraft), nuclear and ballistic missile components, and luxury items (undefined).<sup>46</sup>

*UN Security Council Resolution 1874*: passed in response to North Korea's May 12, 2009, nuclear weapons test, this resolution sought to tighten previous sanctions against North Korea. In particular, it called for expanding the arms embargo to all weapons except small arms, the active inspection of all goods traveling to and from North Korea, and the curtailing of economic transactions with North Korea except when in support of humanitarian or denuclearization purposes. This resolution also established an expert panel to assess current efforts of implementing sanctions on North Korea.<sup>47</sup>

#### ***China's military support for North Korea***

Despite active measures to support the North Korean regime both economically and diplomatically, China appears to be providing North Korea with only minimal military support. David F. Helvey, principal director for East Asia Policy, Office of the Secretary of Defense, described to the Commission how Beijing still has a mutual defense agreement with Pyongyang, the only mutual defense agreement to which China is still obligated.<sup>48</sup> In previous years, Beijing has provided military arms to North Korea but appears to have refrained at least publicly from such activities since

2009, the year of tightened UN sanctions.\* The two countries have also conducted several high-level military exchanges in recent years, including an October 2010 visit to North Korea by General Guo Boxiong, vice chairman of the Central Military Commission.<sup>49</sup> Furthermore, despite the Chinese military's growing international interactions,<sup>†</sup> Commission staff research turned up no confirmed reports of joint military exercises involving Chinese and North Korean troops in the past ten years. A Congressional Research Service report notes that although China supplied ballistic missile components to North Korea in the past, it is unclear whether China continues this support today.<sup>50</sup>

### ***Reasons behind China's support for North Korea***

The overarching goal of China's North Korea policy is to maintain stability in North Korea. A Commission-sponsored research report describes how China's policies toward North Korea revolve around preventing the collapse of the North Korean regime:

*[North Korea's] sinking of the South Korean naval ship Cheonan, the shelling of [South Korea's] Yeonpyeong Island, as well as the seemingly never-ending stand-off over North Korea's nuclear program and proliferation practices provide China with ample opportunity to play a constructive role. But all of China's actions or inactions have served to simply demonstrate that the overriding Chinese interest on the Korean Peninsula is to prevent any increased pressure on the North Korean regime that could potentially lead to an implosion.*<sup>51</sup>

Victor Cha, director of Asian Studies at Georgetown University, testified to the Commission that Beijing has decided to support the North "unconditionally" in order to preserve "a minimum amount of stability in North Korea . . . even if it means acquiescing to North Korean provocation."<sup>52</sup>

Beijing fears a North Korean collapse for several reasons. Should the regime implode, it is likely that a large number of refugees, possibly in the hundreds of thousands, would attempt to flee the dire situation in North Korea by migrating across the border to China. Regional geography plays a major role in ensuring that any chaos in North Korea is likely to bleed over into China's northeast provinces of Liaoning, Heilongjiang, and Jilin. The China-North Korean border is 1,400 kilometers long, sparsely guarded, and very porous.<sup>53</sup> In contrast, North Korea's border with South Korea is heavily mined on both sides.<sup>54</sup> Furthermore, the majority of North Koreans reside along the border with China.<sup>55</sup> Therefore, according to the International Crisis Group, Beijing fears the "threat of an unsustainable flood of hundreds of thousands of refugees, bringing social, criminal and political problems with them."<sup>56</sup> The resulting

\* In 2009, the Stockholm International Peace Research Institute reported that China supplied over \$4 million in small arms sales, the last such report. Stockholm International Peace Research Institute, "Arms Transfer Database" (Stockholm, Sweden: September 6, 2011). <http://www.sipri.org/research/armaments/transfers/transparency/databases/armstransfers>.

† For more on the Chinese military's growing international activities, see the Commission's *2009 Annual Report to Congress*. U.S.-China Economic and Security Review Commission, *2009 Annual Report to Congress* (Washington, DC: U.S. Government Printing Office, November 2009), pp. 113–127. [http://www.uscc.gov/annual\\_report/2009/09\\_annual\\_report.php](http://www.uscc.gov/annual_report/2009/09_annual_report.php).

economic and social strains would seriously impact China's already economically weak northeast, commonly referred to as China's "rust belt."<sup>57</sup>

Beijing also fears that a North Korean political and economic collapse could result in the unification of the peninsula under South Korea, an U.S. ally. Dr. Cha testified that "North Korea is a strategic piece of territory for China, not in the sense that it is intrinsically valuable, but in the sense that Beijing can never allow it to fall in the hands of the South or the U.S."<sup>58</sup> As Selig Harrison, director of the Asia Program at the Center for International Policy, described, "China does not want Korea to be reunified under a South Korean regime allied militarily with the United States, and therefore wants the survival of a pro-Beijing regime in Pyongyang."<sup>59</sup> By keeping a nominally friendly state on its border, China gains the benefit of a buffer state between it and South Korea and, more importantly, U.S. forces stationed in South Korea.<sup>60</sup> Having a buffer state on its borders has been a long-standing interest for Beijing, as demonstrated by its decision to intervene in the Korean War in 1950.<sup>61</sup> China's desire for a buffer state on its borders has grown since the United States declared that it was increasing its focus on East Asia in 2010.<sup>62</sup>

The collapse of the North's government and economy would also negatively impact China's economic interests in North Korea. As mentioned above, North Korea is not a major trade partner of China. However, it does possess natural resources that are valuable to China's continued economic development (see table 2, below). Natural resources accounted for roughly 40 percent (\$465 million) of China's total imports from North Korea in 2010.<sup>63</sup> Chaos within North Korea would inhibit China's ability to extract these resources. In addition, North Korea's collapse would also impact China's goal of developing its economically weak northeast region, which constitutes the bulk of Chinese investment in North Korea.<sup>64</sup> The chaos that would ensue from an implosion of the North Korean regime would also prohibit China from capitalizing on its growing infrastructure investments in North Korea.<sup>65</sup>

**Table 2: North Korea's Estimated Natural Resource Reserves**

<b>Resource</b>	<b>Estimated North Korean Reserves (tons)</b>
Anthracite coal	4,500,000,000
Asbestos	1,300
Barite	210,000
Copper	290,000
Fluorspar	50,000
Gold	200
Iron	5,000,000,000

**Table 2: North Korea's Estimated Natural Resource Reserves—Continued**

Resource	Estimated North Korean Reserves (tons)
Kaolinite	200,000
Lead	1,060,000
Lignite	16,000,000,000
Limestone	100,000,000,000
Magnesite	6,000,000
Molybdenum	5,400
Rosette graphite	200,000
Silver	300–500
Talcum	70,000
Tungsten trioxide	24,600
Uranium ore	400,000
Zinc	2,100,000,000

Source: Adapted from Goohoon Kwon, "A United Korea? Reassessing North Korea Risks (Part I)," (New York, NY: Goldman Sachs and Co., *Global Economics Paper No: 188*, September 21, 2009), p. 10.

Because China's primary goal vis-à-vis North Korea is to prevent North Korea's collapse, coupled with North Korea's need for Chinese support, the two nations find themselves in what Dr. Cha has referred to as a "mutual hostage" situation. Testified Dr. Cha:

*In the end, [China's] support [for North Korea] derives less from some anachronistic communist allegiance, and more from the fact the two are mutual hostages: North Korea needs China to survive. It hates this fact of life and resists all Chinese advice to change its ways. China needs North Korea not to collapse. It hates this fact. And as the only patron supporting the decrepit regime today, it is, ironically, powerless more than it is omnipotent because the regime's livelihood is entirely in Chinese hands. It must therefore countenance [North Korean] bad behavior because any punishment could destabilize the regime.<sup>66</sup>*

### **China's Support for Iran**

China's relationship with Iran is characterized by the prioritization of national interests over international stability. In recent years, while a growing number of states are divesting themselves of investments in Iran's petroleum industry, China has sought to take advantage of these new investment opportunities. China also continues to provide Iran with refined petroleum products, such as gasoline, despite U.S. attempts to embargo this product. Furthermore, open source reporting notes that China may be selling Iran advanced conventional weapons, which would provide Tehran with a growing capacity to threaten U.S. interests in the region.



### ***U.S. sanctions against third-party involvement in Iran***

Over the past several decades, the United States has imposed a series of sanctions on Iran to deter it from supporting international terrorism, pursuing weapons of mass destruction, and abusing human rights. While most of the laws target U.S. companies interacting with Iran, several U.S. laws specifically target foreign companies dealing with Iran.\* These acts mandate that the U.S. government impose three or more of a possible set of nine sanctions upon a foreign entity that is found to violate one of the provisions of the sanctions. Violations include investing in Iran's petroleum industry, supplying it with refined petroleum products, and providing it with technology or know-how related to weapons of mass destruction or advanced conventional weapons. Corresponding penalties include such actions as denying Export-Import Bank loans and export licenses of U.S. military technology to the offending entity, barring the entity from winning U.S. government procurement contracts, and prohibiting the entity from importing goods to the United States or acquiring any U.S.-based property. The various acts also allow the U.S. president to waive the sanctions should it be in the national interest of the United States, or if the foreign entity's home country is cooperating to prevent Iran from acquiring weapons of mass destruction or destabilizing numbers and types of conventional weapons.<sup>67</sup>

### ***China's views on U.S. sanctions***

Beijing views Washington's attempts to punish foreign firms dealing with Iran as the extraterritorial application of U.S. domestic law and thus as an infringement of another state's sovereignty. In response to the December 2005 announcement by the Bush Administration that the United States was sanctioning six Chinese firms † under *The Iran Sanctions Act*, China's Ministry of Foreign Affairs quickly noted its disagreement with the legality of the U.S. law:

*The United States has expressed dissatisfaction with the export of certain items by Chinese enterprises, and has implemented sanctions against these Chinese enterprises under [U.S.] domestic law, to which we indicate our opposition. The reason is simple. The U.S.-imposed sanctions on these Chinese enterprises are not in accordance with international law, nor are they in accordance with international requirements on non-proliferation. Instead they are in accordance with their domestic law. We demand that the U.S. stop the relevant sanctions in order to facilitate the healthy development of Sino-U.S. economic and trade relations on the basis of equality and mutual benefit. At the same time*

\*These laws, collectively referred to as *The Iran Sanctions Act*, include the *Iran Sanctions Act of 1996*, the *Iran Nonproliferation Act of 2000*, the *Iran Nonproliferation Amendment Act of 2005*, the *North Korea Nonproliferation Act of 2006*, the *Iran Freedom Support Act of 2006*, and the *Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010*.

†The six companies were China Aero-Technology Import and Export Corporation (CATIC), China North Industries Corporation (Norinco), Hongdu Aviation Industry Group, Limmt Metallurgy and Minerals Company, Ounion (Asia) International Economic and Technical Cooperation Ltd., and Zibo Chemet Equipment Company. David E. Sanger, "U.S. to Punish 9 Companies Said to Help Iran on Arms," *New York Times*, December 28, 2005. <http://www.nytimes.com/2005/12/28/international/asia/28china.html>.

*we also clearly express, that if we find that Chinese enterprises have truly acted in violation of Chinese government laws and regulations, we will earnestly pursue the issue and punish in accordance with the law.*<sup>68</sup>

China also opposed the 2010 passage of *The Comprehensive Iran Sanctions, Accountability, and Divestment Act*. Following this law's enactment, a spokesperson for the Chinese Ministry of Foreign Affairs stated that:

*China has already noted the U.S. and other parties' announcements to implement unilateral sanctions against Iran. Not long ago, the U.N. Security Council approved Resolution 1929 concerning Iran's nuclear issue. China believes that all nations should fully, seriously, and correctly enforce this Security Council resolution, and avoid interpreting it as one pleases in order to expand the Security Council's sanctions.*<sup>69</sup>

Because Beijing disputes the legality of the U.S. laws, China is generally unwilling to comply with U.S. sanctions regarding Iran. According to John W. Garver, professor of International Relations at the Georgia Institute of Technology:

*Beijing was less willing than the European countries and Japan to follow U.S. policy advice on Iran or to bow before U.S. unilateral actions penalizing non-U.S. firms for involvement in Iran's energy sector. Beijing's greater independence from Washington served China's interest in penetrating Iran's energy sector. China's support for Iran over the nuclear issue and against U.S. pressure also inclined Tehran to see China as a relatively reliable and like-minded partner.*<sup>70</sup>

### ***China's investments in Iran's petroleum industry and provision of refined petroleum products***

While the fear of U.S. sanctions has caused many businesses to limit or cease operations in Iran, Chinese firms have seen these sanctions as an opportunity for expansion. According to a 2011 report by the Government Accountability Office, 20 of the 38 non-Chinese foreign companies with investments in Iran's petroleum industry prior to 2010 have divested (or are in the process of divesting). As these companies leave, however, Chinese (and Indian) companies use the openings to expand their investment in Iran.<sup>71</sup> Dr. Garver testified that by 2009, China and Iran were major energy partners, particularly since 2009, when "Chinese firms entered into eight new energy deals, many of which had been abandoned by Western firms under fear of U.S. sanctions."<sup>72</sup> Robert J. Einhorn, special advisor for nonproliferation and arms control at the U.S. Department of State, referred to China's practice of taking over other countries' contracts when they divest from Iran as "backfilling," which he criticized as "taking advantage of the responsible restraint of other countries."<sup>73</sup> An example of China's backfilling of divested western investments is exemplified by China National Petroleum Corporation, which expanded its investment in

Iran's South Pars Gas Field after several foreign gas companies pulled out of the project.<sup>74</sup>

There is mixed evidence on whether China may be quietly tapering off its investments in Iran's petroleum industry. In April 2011, Mr. Helvey testified to the Commission that the United States had "not seen evidence of new PRC investments in Iran's energy sector." He continued, noting, however, that China still maintains its old investments and that it is continuing to invest in Iran's other extractive resources, such as aluminum, copper, and coal.<sup>75</sup> Erica S. Downs, a fellow at The Brookings Institution, testified to the Commission in April 2011 that "recently, China's national oil companies appear to be following Washington's warning not to backfill projects abandoned by European oil companies and other firms in Iran."<sup>76</sup> According to a September 2011 Reuters article, a Chinese slowdown in further investments in Iran's petroleum industry may reflect "Beijing's efforts to appease Washington and avoid U.S. sanctions on its big energy firms."<sup>77</sup> Table 3, below, lists known Chinese investments in Iran's petroleum industry.

**Table 3: Chinese investments in Iran's Petroleum Industry, 2005-present**

Chinese Company	Activity	Status	Commercial activity
China National Off-shore Oil Cooperation (CNOOC)	Development of the North Pars natural gas field and construction of a liquefied natural gas plant	Initial agreement reached 2006–2007; final agreement signed 2009; expected completion in 2015.	Project valued at \$16 billion; CNOOC to receive 50 percent share of liquid natural gas product
China National Petroleum Corporation (CNPC)	Oil exploration and development project in Masjed-i-Suleiman oil field	Progress stalled since 2010, and the February 2011 deadline was missed	CNPC has a 75 percent holding in project
	Development of Block 3 oil field in the Zagros Basin	Second exploration well started in December 2007	unknown
	Development of the North Azadegan oil field	Equipment procurement problems likely to delay production	Providing 90 percent of the financing under a buyback contract, a \$2+ billion investment
	Development of the South Pars phase 11 natural gas project (replacing France's Total SA)	Contract signed June 2009; deal finalized in February 2010	12.5 percent share of project valued at more than \$4.7 billion
Sinopec	Development of the Yadavaran oil field	Production scheduled to begin in next 1–2 years	Contract valued between \$2 and \$3.6 billion
	Expansion and upgrade of the Arak refinery	As of 2008, estimated completion date was 2011	Contract valued at \$2.8 billion.

**Table 3: Chinese investments in Iran's Petroleum Industry, 2005-present—Continued**

Chinese Company	Activity	Status	Commercial activity
	Development of additional refinery capability	Memorandum of Understanding signed in November 2009; possibly finalized in February 2010	Contract valued at \$6.5 billion

Source: U.S. Government Accountability Office, "Iran's Oil, Gas, and Petrochemical Sectors" (Washington, DC: March 23, 2010), pp. 12–17; U.S. Government Accountability Office, "Firms Reported in Open Sources as Having Commercial Activity in Iran's Oil, Gas, and Petrochemical Sectors" (Washington, DC: August 3, 2011), pp. 16–18; and Foundation for Defense of Democracies, "Iran Energy Project" (Washington, DC: September 7, 2011). <http://www.defend-democracy.org/project/iran-energy-project/>.

However, other reports provide a different picture. In August 2011, a Reuters article noted that Sinopec Engineering Inc., an arm of the state-owned Sinopec, started up a refining unit in Iran's Arak refinery.<sup>78</sup> Although the actual value of this last investment is unknown, an earlier media report noted that Sinopec had signed a Memorandum of Understanding with Iran in November 2009 to invest \$6.5 billion in Iran's oil refineries.<sup>79</sup> In addition, in September 2011, Iran's state-controlled Pars Oil and Gas Company announced that China National Petroleum Company will resume work on Iran's South Pars Gas Field, on hold since 2009.<sup>80</sup> In addition, the U.S. Government Accountability Office in its August 2011 report listed Chinese investment projects in Iran as currently still active.<sup>81</sup>

China is also one of the few countries still willing to sell Iran refined petroleum products.<sup>82</sup> According to the Congressional Research Service, as of mid-2010, China was supplying Iran with about half of Iran's total gasoline imports.<sup>83</sup> Dr. Garver testified that as western companies began tapering off their sales of gasoline to Iran, "China was stepping in to help Iran off-set that Western pressure."<sup>84</sup> Five Chinese companies, each a state-owned enterprise, shipped gasoline to Iran in 2010. ChinaOil, a subsidiary of China National Petroleum Corporation, shipped 600,000 barrels of gasoline to Iran, valued at \$55 million. Sinopec and its subsidiary, Unipet, both shipped a total of 850,000 barrels of gasoline to Iran in 2010 for an undisclosed amount.<sup>85</sup> Two other state-owned enterprises, Zhuhai Zhenrong and Zhenhua Oil, also reportedly supplied Iran with gasoline in 2010.<sup>86</sup>

Despite China's investments in Iran's petroleum industry, and the provision of refined oil products to Iran, the U.S. government has not sanctioned any Chinese state-owned oil company. Noting this fact, Dr. Garver asserted:

*Between 2002 and 2009, nearly 40 Chinese entities were sanctioned 74 times by the United States under U.S. legislation and Executive Orders. Interestingly, however, none of China's oil majors were among the Chinese firms sanctioned in spite of those firms' vigorous entry into Iran's energy sector in the late 2000s and in spite of the apparent applicability of U.S. sanctions laws to those firms' investment in Iran's energy sector.<sup>87</sup>*

When asked by Commissioners about this discrepancy during a hearing in 2011, Daniel Kritenbrink, then acting deputy assistant secretary for East Asian and Pacific Affairs at the U.S. State Department, replied:

*We have made very clear to China that we expect them to show restraint in investments in the energy sector, and this is both in line with U.N. Security resolutions and with U.S. law. China has voted in favor of these Security Council resolutions, and stated that it shares our goal in fully implementing them. And we watch this very carefully and will continue to do so. If we find instances of where Chinese firms have violated those obligations, I can assure you we're going to look at that very carefully and engage with the Chinese very seriously.*<sup>88</sup>

#### ***China's provision of arms and weapons of mass destruction-related materials to Iran***

According to open source reporting, China continues to provide Iran with advanced conventional weapons, an act that could be in violation of U.S. sanctions against Iran.<sup>89</sup> The Stockholm International Peace Research Institute, which tracks open source reporting of international arms sales, notes that over the past five years, China has sold \$312 million worth of arms to Iran, second only to Russia, which supplied Iran with \$684 million worth of arms.<sup>90</sup> Furthermore, since Russia began decreasing its arms sales to Iran in 2008, China has become Iran's largest arms supplier.\*<sup>91</sup> As shown in table 4 below, China's arms sales since 2006 have consisted almost entirely of antiship cruise missiles. In addition to direct sales, there have been media reports that China constructed a missile plant in Iran in 2010 to produce the Nasr-1 antiship cruise missile.<sup>92</sup> In response to a query from the Commission, the U.S. Department of State noted that if these reports are true, the provision of these cruise missiles would be "potentially sanctionable."<sup>93</sup>

**Table 4: Partial List of China's Arms Sales to Iran, 2006–2010**

Item	Quantity	Date Delivered	Range
C-802 antiship cruise missile	340	1994–2010	120 kilometers (km)
FL-6 antiship cruise missile	225	1999–2010	32 km
TL-10/FL-8 antiship cruise missile	120	2004–2010	c. 20 km

\* For example, in September 2010, Russia withdrew from a \$1 billion sale to Iran of Russia's advanced air defense systems, the S-300. United Press International, "Russia ending S-300 Iran deal costs \$1B," September 29, 2010. [http://www.upi.com/Business\\_News/Security-Industry/2010/09/29/Russia-ending-S-300-Iran-deal-costs-1B/UPI-59401285794692/#ixzz1ZLj7ANAk](http://www.upi.com/Business_News/Security-Industry/2010/09/29/Russia-ending-S-300-Iran-deal-costs-1B/UPI-59401285794692/#ixzz1ZLj7ANAk).

**Table 4: Partial List of China's Arms Sales to Iran, 2006–2010—Continued**

Item	Quantity	Date Delivered	Range
C-704 antiship cruise missile	25	2010	c. 35 km
C-801 antiship cruise missile	25	2006–2010	40–80 km
QW-11 man-portable surface-to-air missile	500	2006–2010	5 km

Source: Stockholm International Peace Research Institute, "Arms Transfer Database" (Stockholm, Sweden: September 6, 2011). <http://www.sipri.org/databases/armstransfers>; Global Security.org, "Chinese Missiles." [www.globalsecurity.org/military/world/china/missile.htm](http://www.globalsecurity.org/military/world/china/missile.htm).

Although officially China ended all assistance for Iran's nuclear program in 1997 due to international pressure, there has been speculation that China, or Chinese entities, have quietly continued to provide some support for Iran's pursuit of weapons of mass destruction and ballistic missile capabilities.<sup>94</sup> Chinese companies were accused in March 2009 and 2010 of providing sensitive materials to Iran for its nuclear program.<sup>95</sup> In April 2009, a New York grand jury indicted the Chinese firm LIMMT Economic and Trade Co. for covertly using U.S. banks to finance the sale of restricted high-strength metals with military applications to subsidiaries of an Iranian military agency, potentially supporting Tehran's ballistic missile and nuclear weapons programs.<sup>96</sup> Secretary of State Hillary Rodham Clinton noted during President Hu's January 2011 visit to the United States that "we think that there are some entities within China that we have brought to the attention of the Chinese leadership that are still not, shall we say, as in compliance as we would like them to be" with international efforts to not provide Iran with nuclear technology and know-how.<sup>97</sup> In late spring 2011, a UN report posited that Iran had acquired ballistic missile technology from North Korea by transshipping the technology through "a neighboring third country," alleged to be China.<sup>98</sup> In May 2011, the U.S. State Department sanctioned three Chinese companies and one Chinese citizen for their role in weapons proliferation involving Iran under *The Iran, North Korea, and Syria Nonproliferation Act*.<sup>99</sup> It is unclear from reports, however, what items were proliferated and what was sent specifically to Iran, as opposed to Syria or North Korea.

### **Implications for the United States**

China's continued support for Iran and North Korea have several implications for the United States. By continuing to defend Iran and North Korea in international fora, China undermines international efforts to compel these countries to discontinue pursuing agendas and programs that destabilize their respective regions. China's tactics to weaken and delay international resolutions and reports provide both North Korea and Iran with valuable time to develop their respective nuclear programs. Knowing that they can rely on China to defend them from international criticism creates

\*The individuals and entities sanctioned were Karl Lee, Dalian Sunny Industries, Dalian Zhongbang Chemical Industries Company, and Xian Junyun Electronic.

Office of the Spokesperson, "Fact Sheet: Iran, North Korea and Syria Nonproliferation Act" (Washington, DC: U.S. Department of State, May 24, 2011). <http://www.state.gov/r/pa/prs/ps/2011/05/164129.htm>.

moral hazard in Pyongyang and Tehran where China's support insulates North Korea and, to a lesser extent, Iran, from the risk of their actions. As a consequence, China's diplomatic defense could embolden these nations, particularly North Korea, to undertake further destabilizing actions.

China's economic relationships with North Korea and Iran undermine international attempts to dissuade sanctioned activities by providing these regimes with a means to acquire much-needed capital. Chinese investments and infrastructure deals provide hard currency that can be diverted to finance questionable programs. By providing valuable commodities, such as refined petroleum, to Iran, China allows the North Korean and Iranian elites to maintain their hold on these countries. Furthermore, China's lax implementation of international sanctions allows these countries to continue to both acquire and proliferate sanctioned items.

Finally, if reports of China's arms sales to Iran are true, China's willingness to continue to sell to Iran advanced conventional arms and dual-use technology would enhance Iran's conventional military capabilities, thus providing Iran with a growing capacity to threaten the region. A study from the Center for Strategic and Budgetary Assessments notes that, like China, "Iran seems determined to continue developing more formidable A2/AD [antiaccess and area denial] capabilities." To this end, China-supplied ballistic and cruise missiles "could be used not only to target Persian Gulf shipping, but also to hold at risk the oil and natural gas production facilities (to include overland pipelines) of other Gulf states."<sup>100</sup> Even minimal physical damage, for example, to Saudi Arabian production, refinement, or overland transport capacity would disproportionately affect energy markets and surge prices.<sup>101</sup> With respect to shipping, China's provision of antiship cruise missiles to Iran could allow Iran to target, among other things, oil tankers transiting the Strait of Hormuz. According to one analysis of this threat, "[e]xtended closure of the strait would remove roughly a quarter of the world's oil from the market, causing a supply shock of the type not seen since the glory days of OPEC [Organization of Petroleum Exporting Countries]."\* Even relatively limited or ineffectual attacks could cause tanker operations in the area to cease or would at least increase insurance rates.<sup>102</sup>

### Conclusions

- China has continued over the past year to support North Korea despite North Korea's destabilizing actions. Diplomatically, China shields North Korea from pressure in international fora. China also continues to trade with and invest in North Korea, providing it with an economic lifeline in the face of growing international ostracism. Beijing's continued support for Pyongyang is primarily driven by its fear of a collapse of the North Korean regime and the consequences this would have for

\*This analysis also reviews Iranian mine warfare and missile warfare capabilities. It concludes that, between mines and missiles, "[i]t does not take much imagination to suggest that the traffic in the Strait of Hormuz could be impeded for weeks or longer, with major air and naval operations required to restore the full flow of traffic." See Caitlin Talmadge, "Closing Time: Assessing the Iranian Threat to the Strait of Hormuz," *International Security* 33: 1 (Cambridge, MA: Summer 2008): 82.

China's economic, social, and security interests; as well as the fear of the loss of a buffer state on its border.

- Despite U.S. efforts to sanction Iran for its support of international terrorism and pursuit of weapons of mass destruction, China remains a large investor in Iran's petroleum industry and a major provider of refined oil products. China may also be supplying Iran with advanced conventional weapons, such as cruise missiles. China's investments in Iran's petroleum industry, and its continued provision of gasoline and advanced conventional weapons, may be at odds with U.S. laws.
- Continued Chinese support for North Korea and Iran demonstrates China's willingness to place its national interests ahead of regional stability by providing economic and diplomatic support to countries that undermine international security.



## SECTION 2: ACTORS IN CHINA'S FOREIGN POLICY

### Introduction

Through a combination of hearings, two fact-finding trips to East Asia, and research over the past year, the Commission investigated the changing dynamics of China's foreign policy-making. Overall, the Chinese Communist Party (CCP) elite, the party's Politburo Standing Committee, continue to exert overarching control of China's foreign policy-making. Other party and government entities, such as the Ministry of Foreign Affairs, the People's Liberation Army (PLA), and provincial actors, influence and implement China's foreign policies. However, as China has expanded its overseas interests, the number of voices affecting Chinese foreign policy also has increased. Chinese state-owned enterprises (SOEs) and banks, and think tanks and academic institutions have increasing influence on China's foreign policies. In addition, private citizens may have a modicum of ability to influence foreign policies through the use of the Internet. As a result of the growing number of players influencing China's foreign policy-making process, coordination among the various actors is more difficult for Beijing. The following section will describe the actors creating, implementing, and influencing Chinese foreign policy and what implications the proliferation of voices could have for the United States.

### Official Chinese Foreign Policy Actors

China's official foreign policy actors include individuals and organizations in the CCP apparatus and in the Chinese government under the State Council. The most influential actors are the Politburo Standing Committee, the Foreign Affairs Leading Small Group, the Ministry of Foreign Affairs, the PLA, and on a smaller scale, provincial governments.

### *Politburo Standing Committee of the CCP*

Comprising the top nine members of the CCP, the Politburo Standing Committee is the ultimate body that approves foreign policy decisions. Although it does not publicize its agenda, the Politburo Standing Committee reportedly meets every seven to ten days and operates on a consensus basis; no one member has exclusive say over foreign policy decisions.<sup>103</sup> In testimony to the Commission, Susan Lawrence, an analyst at the Congressional Research Service, stated that the two members of the Politburo Standing Committee who have the greatest involvement in foreign policy are current President and Party Chairman Hu Jintao and Vice President Xi Jinping (who is likely to become president and party chairman in 2012).<sup>104</sup> However, as a Commission-sponsored report

noted, 2012 may herald changes to the foreign policy-making dynamics on the Politburo Standing Committee as new leaders attempt to jockey for power during China's leadership transition.<sup>105</sup>

### ***Foreign Affairs Leading Small Group of the CCP***

The party's Foreign Affairs Leading Small Group\* is a coordinating body comprised of representatives from party leadership organs, the government, and the military. Although China does not publicize the membership of the Foreign Affairs Leading Small Group, reports suggest that its members include the state councilor (see text box below); the head of the CCP's International Department;† the ministers of foreign affairs, commerce, defense, state security, and public security; leading officials in charge of propaganda, Taiwan policy, and Hong Kong and Macau affairs; and a deputy chief of the PLA's General Staff Department.‡<sup>106</sup> The role of the group is to analyze major foreign policy issues and make recommendations to the Politburo Standing Committee on policy decisions. However, Ms. Lawrence testified that several analysts believe that the Foreign Affairs Leading Small Group has not met as a full body for almost two years. She stated that this suggests that President Hu and Vice President Xi "feel comfortable running foreign policy without regular input from the full membership."<sup>107</sup>

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\*Leading small groups in China are ad hoc policy and coordination working groups, the membership of which consists of Chinese political elites. The creation of such groups of high-level officials allows the Chinese government to focus efforts and resources from various ministries and departments on issues or projects that the central government feels are important. U.S.-China Economic and Security Review Commission, *2010 Annual Report to Congress* (Washington, DC: U.S. Government Printing Office, November 2010), p. 98.

†The International Department is a body within the CCP that maintains and builds links with foreign political parties, including noncommunist parties such as the Democratic and Republican parties in the United States. It also facilitates contacts with think tanks and non-governmental organizations worldwide. David Shambaugh, "China's 'Quiet Diplomacy': The International Department of the CCP," *China: An International Journal* 5:1 (March 2007): 26–54.

‡The PLA General Staff Department is the military command headquarters for the PLA. Its duties include planning, organizing, and directing military operations; and conducting staff work for the top leadership of the PLA to assist them in decision-making. David Finkelstein, "The General Staff Department of the Chinese People's Liberation Army: Organization, Roles and Missions," in James Mulvenon, *The People's Liberation Army as Organization* (Arlington, VA: RAND Corporation, 2002), pp.122–123. [http://www.rand.org/pubs/conf\\_proceedings/CF182/CF182.ch4.pdf](http://www.rand.org/pubs/conf_proceedings/CF182/CF182.ch4.pdf).

***State Councilor Dai Bingguo***

China's State Councilor Dai Bingguo advises the premier and vice premier of the State Council of the Chinese government (currently Wen Jiabao and Li Keqiang, respectively) and outranks the ministers of foreign affairs and commerce. In addition to his position in the Chinese government, State Councilor Dai also has influence among the CCP leadership as a full member of the CCP Central Committee\* and as the former head of the CCP International Department and the former party secretary of the Ministry of Foreign Affairs.<sup>108</sup> In his role as state councilor, State Councilor Dai is often considered China's top diplomat and serves as U.S. Secretary of State Hillary Rodham Clinton's counterpart in important bilateral meetings, such as the annual U.S.-China Strategic and Economic Dialogue.<sup>109</sup>

Unlike the U.S. State Department, which is instrumental in formulating and implementing foreign policy, China's Ministry of Foreign Affairs primarily implements foreign policies that have been approved by the Politburo Standing Committee and the Foreign Affairs Leading Small Group. For example, Chinese ambassadors, who serve under the Ministry of Foreign Affairs, generally neither approve nor direct policy; they can only make recommendations to higher-ups. In states deemed less vital to China's national interests, the ministry enjoys more leeway in determining policies.<sup>110</sup> In testimony to the Commission, Daniel Kritenbrink, then acting deputy assistant secretary of State in the Bureau of East Asian and Pacific Affairs, explained the challenges of liaising with China's Ministry of Foreign Affairs due to its limited role in foreign policy-making:

*The [Chinese] Ministry of Foreign Affairs, while being the [U.S.] State Department's primary counterpart, [is] one of several voices and institutions involved in the making of Chinese foreign policy. . . . Given the structure of the Communist Party and the Chinese government, the ultimate decisions are made at a much higher level.*<sup>111</sup>

According to several witnesses who testified to the Commission, the role of the Ministry of Foreign Affairs in foreign policy-making has diminished over the past decade.<sup>112</sup> David Lampton, director of China Studies at The Johns Hopkins School of Advanced International Studies, testified that "no longer do [China's Ministry of] Foreign Affairs offices control the gateways to the outside world as they once did."<sup>113</sup> Some analysts assert that the reasons for the decline in influence include the Ministry of Foreign Affairs' increasing reliance on other agencies for expertise and its competition with a multitude of other actors advancing their interests overseas.<sup>114</sup> For

\*The full CCP Central Committee, elected by the National Congress of the Communist Party of China, is composed of 371 top Chinese leaders from the party, state, and army. The body nominally elects members of the Politburo (25 members), which appoints the Politburo Standing Committee (nine members). However, most analysts agree that the Central Committee as a full body does not have much real power in Beijing and merely serves as a rubber stamp for decisions already made by the Politburo and the Politburo Standing Committee. Nevertheless, departments within the body can be very influential. Kenneth Lieberthal, *Governing China: From Revolution Through Reform* (New York, NY: W.W. Norton & Company, Inc., 1995), pp. 78-79; Xinhua, "New CPC [Communist Party of China] central committee elected," October 21, 2007. [http://news.xinhuanet.com/english/2007-10/21/content\\_6917379.htm](http://news.xinhuanet.com/english/2007-10/21/content_6917379.htm).

example, according to Ms. Lawrence, many of the Chinese players in Africa, including SOEs, banks, and private entrepreneurs, do not necessarily feel compelled to coordinate their activities with the Ministry of Foreign Affairs because they have their own connections and expertise on the ground in African countries.<sup>115</sup> In addition, the Ministry of Foreign Affairs must compete for influence with other organizations, such as the Ministry of Commerce, which holds jurisdiction over foreign trade, and the National Development and Reform Commission (NDRC), which has major influence over China's economic development, specifically in the energy sector.<sup>116</sup>

### ***People's Liberation Army***

The PLA historically was much more involved in China's foreign policy-making process, with prominent military officers holding powerful positions on the Politburo Standing Committee. Today, no uniformed member of the PLA sits on the Politburo Standing Committee, and thus the military officially does not have a direct voice in Chinese foreign policy. However, President Hu and Vice President Xi currently preside over the Central Military Commission, the military's supreme decision-making body, ensuring that the interests of the military are represented on the Politburo Standing Committee, albeit unofficially. In addition, because of the PLA's expertise on defense-related issues, it can influence the policy-making process. In testimony to the Commission, David Helvey, principal director for East Asia for Asia Pacific Security Affairs at the Department of Defense, stated, "[a]s China's interests have expanded, there is a greater intersection between China's defense and foreign policies, giving the PLA a greater role in shaping debates—particularly public debate—on foreign and security policy."<sup>117</sup> Linda Jakobson and Dean Knox explain the PLA's foreign policy role in a study by the Stockholm International Peace Research Institute:

*The PLA shares authority with government and commercial entities on decisions pertaining to arms control and non-proliferation—spheres with direct foreign policy implications over which the PLA formerly exercised nearly unquestioned authority. The PLA still holds sway in these and other defence-related foreign policy issues, particularly with respect to policies related to strategic arms, territorial disputes and national security towards countries such as India, Japan, North Korea, Pakistan, Russia and the USA. In particular, the PLA is a staunch advocate of a hard line towards Taiwan and perceived US interference in cross-Strait relations.*<sup>118</sup>

In recent years, the PLA appears to have grown more assertive in expressing its views. Yu-Wen Julie Chen, visiting scholar at the University of Virginia, testified to the Commission that the PLA has apparently "trespassed on the Foreign Ministry's conventional role as the mouthpiece of foreign affairs" and has been more willing to publicly express opinions that differ from those of the senior civilian leadership.<sup>119</sup> A representative from Singapore's Ministry of Defense told the Commission that this shift began to surface immediately following the global financial crisis as many of the PLA's hard-line leaders grew more confident in China's relatively un-

scathed economy relative to its western counterparts.<sup>120</sup> Some of the means that the PLA has used publicly to assert its views on foreign policy are military publications and op-eds penned by senior military officials in prominent newspapers.<sup>121</sup>

This deviation from official policy has led several observers to assert that the PLA is actually becoming more autonomous. They point to the 2007 Chinese antisatellite test\* and the January 2011 test of the J-20 stealth fighter jet during then U.S. Secretary of Defense Robert Gates' visit to Beijing as evidence that the military is acting without approval from President Hu and the rest of the Politburo Standing Committee.†<sup>122</sup> However, others argue that these incidents merely display a lack of coordination among Chinese foreign policymakers, particularly between the PLA and the Ministry of Foreign Affairs, and do not represent a fundamental change in who creates China's foreign policy.<sup>123</sup> Others believe that the civilian leadership in China strategically allows the PLA publicly to voice more extreme views and then distances itself from those opinions so as to add a degree of uncertainty to its interactions with other countries.<sup>124</sup> Because of the opacity that surrounds civil-military relations in China, it is unclear which of these theories, or combinations of them, are correct. As Alan Wachman, professor at Tufts University, testified to the Commission, "[e]ven though it is a widespread perception that the PLA is resurgent and the Ministry of Foreign Affairs is in a diminished state of influence, I don't think any of us really is in a position to say that we know that to be the case."<sup>125</sup>

### ***Chinese Provinces ‡***

Although China's management of foreign affairs is highly centralized, Chinese provinces sometimes act as agents of the central government or as partners with the central government in creating and implementing foreign policies related to trade and security.<sup>126</sup> This is especially the case with China's border provinces, which often act as China's "front line" of engagement with its neighbors.<sup>127</sup> The provincial foreign policy-making bureaucracy both reflects and complements that of the central government: Governors and provincial party secretaries are the top decisionmakers and have the same status as ministers in the central government. These individuals usually lead provincial foreign affairs leading

\* On January 11, 2007, China conducted its first successful antisatellite weapon test, during which it shot down an aging weather satellite with a ballistic missile. However, the Ministry of Foreign Affairs did not release an official statement about the test until 12 days later, leading analysts to question whether President Hu Jintao and other leaders in the Chinese government knew about the PLA's intentions prior to conducting the test. Shirley A. Kan, "China's Anti-Satellite Weapon Test" (Washington, DC: Congressional Research Service, April 23, 2007), p. 4. <http://www.fas.org/sgp/crs/row/RS22652.pdf>.

† During Secretary Gates' January 2011 trip to Beijing, the PLA conducted a test of its J-20 stealth fighter jet. When Secretary Gates asked President Hu about the test, the Chinese leader said he was not aware that it had taken place, leading some western analysts to question whether the military deliberately did not inform President Hu. For more information on the J-20 and its test flight, see chapter 2, section 1, of this Report. Jeremy Page and Julian Barnes, "China Shows its Growing Might: Stealth Jet Upstages Gates, Hu," *Wall Street Journal*, January 12, 2011. <http://online.wsj.com/article/SB10001424052748704428004576075042571461586.html>.

‡ For the purposes of this section, the term "provinces" will refer to provincial-level entities in China, including provinces, autonomous regions, municipalities, and special administrative regions.

small groups to coordinate and direct local foreign relations.‡<sup>128</sup> Many provincial leaders also are powerful actors in the central government, and currently provincial leaders hold two of the nine seats on the Politburo Standing Committee and ten of 25 Politburo seats.§

Under the stewardship of central government ministries, Chinese provinces are empowered to be economic liaisons and international dealmakers, fulfilling China's "going out" strategy\* and creating economic growth locally. Provincial leaders are responsible for creating and implementing local foreign trade strategies and managing provincial SOEs.<sup>129</sup> Border provinces such as Jilin and Liaoning (opposite North Korea), and Yunnan (opposite Burma, Laos, and Vietnam) create and implement policies to foster economic engagement across their borders, often with heavy political and financial support from the central government. Jilin is a leading actor in support of China's engagement policy toward North Korea. The province invests in open border cities, economic cooperation zones, joint ventures, and cross-border infrastructure and aims to advance national policies to secure resources, create wealth, and promote economic stability across the border.†<sup>130</sup> Yunnan Province has similar trade-liberalizing policies along its border with Vietnam and Burma.<sup>131</sup> Reflecting on Yunnan's role as an integral link to China's southern neighbors, President Hu toured Yunnan in 2009 and declared the province a "bridgehead" for China's relations with South and Southeast Asia, a pronouncement that inspired widespread investments in infrastructure and commerce under the banner of a new "bridgehead strategy."<sup>132</sup>

The provinces also are agents of China's foreign policies related to security and defense, pursuing regional security goals, and maintaining internal and external stability along China's borders. This is especially the case in regard to North Korea, which could create a problem for China in the event of a human security disaster (including the possibility of refugees flooding into China). In such a case, provincial and local officials would be responsible for the

‡ Provincial-level management of foreign relations under governors and provincial party secretaries is conducted by provincial Foreign Affairs Offices and Foreign Trade and Economic Cooperation Commissions, which manage foreign diplomatic relations and foreign trade relations, respectively. Chen Zhimin, "Coastal Provinces and China's Foreign Policy-making," in Yifan Hao and Lin Su, eds., *China's Foreign Policy Making: Societal Force and Chinese American Policy* (Aldershot, UK: Ashgate Publishing Limited, 2005), pp. 11–12. <http://www.cewp.fudan.edu.cn/attachments/article/68/Chen%20Zhimin,%20Coastal%20Provinces%20and%20China%27s%20Foreign%20Policy%20Making.pdf>.

§ Liaoning and Shanghai are represented in the Politburo Standing Committee; Beijing, Tianjin, Jiangsu, Hubei, Guangdong, Xinjiang, and Chongqing are represented in the Politburo. Linda Jakobson and Dean Knox, *New Foreign Policy Actors in China* (Stockholm, Sweden: Stockholm International Peace Research Institute (SIPRI), Policy Paper 26, September 2010), p. 32. <http://books.sipri.org/files/PP/SIPRIPP26.pdf>.

\* China's "going out" strategy was formally enunciated in 2002 by then Chinese President Jiang Zemin as a strategy to help China open up to the world, economically and diplomatically. U.S.–China Economic and Security Review Commission, *2008 Annual Report to Congress* (Washington, DC: U.S. Government Printing Office, November 2, 2008), p. 236.

† Jilin represents 38 percent of China's accumulated foreign direct investment (FDI) to North Korea since 2000, and North Korea is the province's fourth-largest trading partner. While this heavy investment has contributed to economic growth in Jilin, it also makes Jilin particularly vulnerable to North Korea's unpredictable suspensions of cross-border trade. Bloomberg News, "Dead Border' Is Price of China Support for North Korea Regime," June 14, 2010. <http://www.bloomberg.com/news/2010-06-14/dead-border-thwarts-growth-as-chinese-pay-price-for-backing-north-korea.html>; Carla Freeman and Drew Thompson, *China on the Edge: China's Border Provinces and Chinese Security Policy* (Washington, DC: The Center for the National Interest and The Johns Hopkins School for Advanced International Studies, April 2011), pp. 36–39. [http://www.cftni.org/China\\_on\\_the\\_Edge\\_April\\_2011.pdf](http://www.cftni.org/China_on_the_Edge_April_2011.pdf).

management of border control, fire fighting, internal security, managing displaced persons, and operating refugee camps, *inter alia*.<sup>133</sup> (For more information on China's security polices related to North Korea, see chap. 3, sec. 1, of this Report.) Similarly, in China's westernmost province of Xinjiang, the quasi-military Xinjiang Production and Construction Corps plays a multifaceted role in China's political relationship with its Central Asian neighbors by managing border defense and meeting with foreign leaders.<sup>134</sup> Provincial leaders and law enforcement personnel also are the primary actors dealing with transnational threats like human and drug trafficking, the spread of HIV/AIDS, and political crises in bordering countries.\* Coastal provinces also have provincial maritime law enforcement programs, which add to China's already robust maritime presence.<sup>135</sup> (For more information on China's maritime policies in the South China Sea, see chap. 2, sec. 1, of this Report.)

### **Nontraditional Chinese Foreign Policy Actors**

Aside from the official Chinese actors that are responsible for creating and implementing Chinese foreign policy, a number of nontraditional actors are increasing in importance. SOEs and state-owned banks, Chinese academics and think tanks, and a growing number of Internet users are all beginning to have a voice in foreign affairs and are seeking ways to become more influential in the policy-making process.

#### ***State-owned Enterprises***

As China's SOEs have expanded their global reach, their influence in China's foreign policy-making has grown as well. Large SOEs dominate strategic industries, such as the energy and telecommunications sectors, providing them with many connections to Beijing's political elites. These companies influence foreign policy by virtue of their leaders' access to official policy-making bodies, their expertise in national strategic industries, and their employment of Chinese workers and provision of capital for Beijing.<sup>136</sup> (For more information on China's SOEs, see chap. 1, sec. 2, of this Report.)

Executives of SOEs, especially those in strategic sectors like petroleum, minerals, nuclear, and defense, often have membership in or access to official decision-making bodies in China. Heads of all major SOEs under the central government are appointed by the party's Organization Department and Ministry of Personnel, and some of these individuals hold ministerial or vice-ministerial rank or serve as alternate members of the CCP Central Committee (for example, the general managers of China's three largest state-owned oil companies are vice ministers).<sup>137</sup> While these official positions do not give companies power to make important foreign pol-

\* Yunnan and Guangxi provinces also work to resolve transnational security problems through participation in the Greater Mekong Subregion, a cooperation organization in which these provinces and five Southeast Asian nations work with the Asian Development Bank and other partners to enhance cooperation in nine security, economic, cultural, technological, and environmental sectors. Asian Development Bank, "Greater Mekong Subregion" (Manila, Philippines: July 22, 2011). <http://www.adb.org/gms/>; Carla Freeman and Drew Thompson, *China on the Edge: China's Border Provinces and Chinese Security Policy* (Washington, DC: The Center for the National Interest and The Johns Hopkins School for Advanced International Studies, April 2011), pp. 71–73. [http://www.cftni.org/China\\_on\\_the\\_Edge\\_April\\_2011.pdf](http://www.cftni.org/China_on_the_Edge_April_2011.pdf).

icy decisions directly, they enable state-owned company executives to take part in implementing and debating policies that come from higher up.<sup>138</sup> Business executives also maintain close ties to high-ranking officials. According to a Stockholm International Peace Research Institute report, Fu Chengyu, chief executive officer of China National Offshore Oil Corporation, is said to have access to Foreign Minister Yang Jiechi “any time he wants.”<sup>139</sup>

Moreover, there is a “revolving door” of political and industrial appointments through which highly ranked personnel in government bodies and state-owned companies are promoted from one sector to the other, enabling business executives and government officials to take their expertise and professional networks from the government to the business sector, or vice versa. For example, former heads of large companies have become members of the Politburo Standing Committee or the CCP Central Committee or have become governors or provincial party secretaries.<sup>140</sup> This revolving door particularly applies to China’s oil industry, which is known to undergo occasional personnel “shake-ups” during which oil executives are moved from company to company or from a company to a powerful government position.<sup>141</sup> This system facilitates tied interests between the energy sector and the government and ensures that the governing elites always have a hand in this strategic industry.<sup>142</sup> For example, Zhou Yongkang, a current member of the Politburo Standing Committee, is the former head of China National Petroleum Corporation, one of China’s largest state-owned oil companies. Erica Downs, fellow at The Brookings Institution, testified to the Commission that some analysts assert that Mr. Zhou has used his position on the Politburo Standing Committee to liaise with and promote the interests of the national oil companies.<sup>143</sup>

SOEs also provide valuable expertise to policymakers. Dr. Chen testified to the Commission that SOEs are able “to provide . . . detailed and expert knowledge on certain vital issues [which] increases their value for decision-makers.” Because these companies have extensive, on-the-ground experience in numerous countries, their managers often are experts on the foreign countries’ government structures and market conditions. Chinese leaders often rely on this knowledge to inform their foreign policy-making decisions.<sup>144</sup>

SOEs operating overseas are important contributors to China’s economic growth and its ability to employ its burgeoning work force. National SOEs provide the government with massive revenues and employ 6.8 million Chinese workers, most of whom work overseas.<sup>145</sup> As more workers go abroad to work for these SOEs, the Chinese government must find ways to protect them if the country in which they are working becomes destabilized or is victim to a terrorist attack or natural disaster. For example, after the turmoil began in Libya this past year, the PLA and the Ministry of Foreign Affairs worked to evacuate almost 36,000 Chinese citizens from the country, making it one of the largest and most complicated overseas evacuations of Chinese citizens in the history of the People’s Republic of China (PRC).<sup>146</sup> (For more information about the Libya evacuation, see chap. 2, sec. 1, of this Report.) Because the decisions taken by these companies can directly affect



China's economic growth and the livelihood of Chinese workers, leaders are apt to incorporate the companies into the policy-making process, whether it be foreign policy or otherwise.<sup>147</sup>

SOEs often advance China's national "going out" policy to secure resources to fuel China's economic growth and broaden China's global footprint. Their myriad global economic interests sometimes can be at odds with China's wider foreign policy goals.<sup>148</sup> For instance, state-owned oil companies operating in unstable or "rogue" countries like Sudan and Iran have attracted the ire of the international community.\*<sup>149</sup> In the case of Sudan, the NDRC removed the country from a list of preferred destinations for Chinese oil investments in 2007, but two state-owned oil companies ignored the NDRC's guidance and continued to purchase Sudanese oil assets.<sup>150</sup> Dr. Downs testified that the state-owned oil companies rarely coordinate their overseas activities with government ministries and that some Chinese scholars think that the national oil companies are "hijacking the foreign policy process" in Sudan and Iran.<sup>151</sup>

### ***State-owned Banks***

Two of China's state-owned banks are responsible for supporting government policy objectives abroad: China Development Bank and the Export-Import Bank of China. Both banks operate under the State Council, and China Development Bank has full ministerial rank.<sup>152</sup> China Development Bank and the Export-Import Bank of China play a key role in the financing of China's foreign economic activities. China Development Bank has facilitated several billion dollars' worth of Chinese companies' investments abroad, making it a key player in China's "going out" strategy, especially when it comes to acquiring energy resources. The Export-Import Bank of China is responsible for facilitating foreign trade and allocating China's foreign aid.<sup>153</sup>

Many of China Development Bank's loans require a high degree of cooperation between the central government and business, with the bank acting as the main coordinating body between the two.<sup>154</sup> Government entities often are at the forefront of China's high-profile strategic energy deals overseas; however, China Development Bank sometimes plays the leading role in identifying investment opportunities and coordinating deals.<sup>155</sup> Such was the case for a \$10 billion oil-backed loan to Brazil's national oil company, Petrobras, in 2009. China Development Bank, which had been conducting market research in Brazil since 2000, proposed the loan, which Beijing later supported as a diplomatic deliverable for upcoming state visits with Brazil. Dr. Downs writes of the deal in "Inside China Inc.: China Development Bank's Cross-Border Energy Deals":

*The coincidence of the negotiations between [China Development Bank] and Petrobras with the preparation for the two sets of meetings between Chinese and Brazilian leaders prompted the Chinese government to embrace the deal as a*

\*Sudan and Iran constituted the fourth- and fifth-largest sources of China's crude oil imports for January 2011. ChinaOilWeb.com, "China's Crude Oil Imports Data for January 2011." <http://www.chinaoilweb.com/UploadFile/docs/Attachment/2010-3-169132990.pdf>.

*symbol of the growing economic ties between China and Brazil. According to Chen Yuan [governor of China Development Bank], 'once the Ministry of Foreign Affairs, Ministry of Commerce, the National Development and Reform Commission and the State Council realized this coincidence, they provided their active support. As a result, this project became a national project.'*<sup>156</sup>

### **Academics and Think Tanks**

As China's foreign policy becomes more complex, its leaders increasingly are turning to academics and think tanks to inform their debates about policies related to international affairs. Think tanks and universities operate under varying degrees of official administration, with many think tanks funded entirely by the government and major universities overseen by party officials. For this reason, some doubt the independence and the reliability of the information these institutions are providing to policymakers. A study by the Brussels Institute of Contemporary China Studies characterizes Chinese think tanks as:

*[P]ermanent, policy oriented structures with their own research staff who regularly publish and communicate the results of their studies to officials and to the public, albeit to a lesser extent than their Western counterparts. They all strive to achieve greater freedom of research and to contribute to the public good, although these orientations are of course bound by the red lines set by the government and by the need to respect the primacy of the CCP in their policy solutions.*<sup>157</sup>

Chinese scholars influence foreign policymakers through formal channels and informal connections to top leaders.<sup>158</sup> For example, think tanks often submit reports to their affiliated government organizations, and academics are sought out by government officials to participate in meetings or conferences on foreign policy issues.<sup>159</sup> Their opinions often differ, and at times debates between scholars are made public in the media. An example of this type of debate took place in December 2009 when the Chinese newspaper *Global Times* published a debate between two scholars about whether China should intervene militarily in Afghanistan.<sup>160</sup> However, on particularly sensitive core issues for the CCP, such as Taiwan and Tibet, leaders allow little leeway for scholarly debate in public fora.<sup>161</sup>

#### **Major Chinese foreign policy research institutions and their affiliations**<sup>162</sup>

<b>Institution</b>	<b>Administering organization</b>
<i>Communist Party</i> International Strategy Research Institute	Central Party School
<i>People's Liberation Army</i> Academy of Military Sciences	Central Military Commission
National Defence University	Central Military Commission
China Institute for International Strategic Studies	PLA General Staff Department
China Foundation for International Strategic Studies	PLA General Staff Department

**Major Chinese foreign policy research institutions and their affiliations—Continued**

<i>Government</i>	
Development Research Centre	State Council
Chinese Academy of Social Sciences	State Council
China Institute of International Studies	Ministry of Foreign Affairs
China Institutes of Contemporary International Relations	Ministry of State Security
China Center for International Economic Exchanges	National Development and Reform Commission
<i>Local Government</i>	
Shanghai Institutes for International Studies	Shanghai City Government
<i>Academic*</i>	
Institute of International Relations	China Foreign Affairs University
Strategy and Conflict Research Center	China Foreign Affairs University
Institute of International Studies	Fudan University
School of International Studies	Peking University
School of International Studies	Renmin University
Institute of International Studies	Tsinghua University
Institute of International Strategy and Development	Tsinghua University

Chinese leaders often use think tanks and academia not only as a resource but also as a platform for testing potentially controversial foreign policies and gauging the response. Ms. Lawrence testified to the Commission that Beijing uses “semi-official actors” from scholarly institutions to float ideas, and that:

*[There is an] interesting relationship between scholars and the government. On the one hand, they sometimes will present themselves as being independent analysts of the situation, and yet there are classes of scholars who are cleared by the government to essentially speak for it and also to run with certain kinds of ideas and see what kind of response they get from them.<sup>163</sup>*

### **Public Opinion and Internet Users**

While not nearly as influential as some of the above-listed groups, public opinion and Internet users are growing increasingly influential in foreign policy-making as Internet use becomes more prevalent in China. There are over 500 million Internet users in China, 195 million of which are active bloggers, many of whom utilize the Internet as a forum for the discussion of politics, governance, and foreign affairs, among other things.<sup>164</sup> The Commission’s 2010 *Annual Report to Congress* notes:

*China’s leadership, at all levels of the government, increasingly uses the Internet to interact with the Chinese people. This practice, interwoven with strict censorship controls, affords the government the ability to allow a controlled online debate about certain issues ... The government then*

\*Most Chinese university-affiliated research institutes are administered by the Ministry of Education and lack substantial links to foreign policymakers in China. However, some experts from these institutions are well known and have influence on foreign policy-making. Thomas J. Bickford and Kristen Gunness, *China’s International Relations Think Tanks: Structure, Roles, and Change* (Alexandria, VA: The CNA Corporation, September 2007), p. 5.

*leverages what it learns from following this debate to construct policies that aim to undercut the most serious irritants to domestic stability.*<sup>165</sup>

In addition to monitoring the debate on domestic issues, the Chinese government uses the Internet and public opinion to gauge the opinions of Internet users on China's foreign policy decisions. While the government largely censors the Internet in China, it also is sensitive to the reactions of the Chinese people. David Shambaugh, professor at The George Washington University, notes:

*The Chinese government is quite sensitive to this body of public opinion, as much of it is hyper-nationalistic and critical of the government for being 'weak' or 'soft' in the face of foreign pressures and indignities. Foreign Ministry officials are quick to point out that this is a constituency they must constantly consider, react to, and attempt to control.*<sup>166</sup>

The ability of Internet users to mobilize en masse around a foreign policy issue was evident in 2005 when 40 million Chinese signed an Internet petition opposing Japanese attempts to become a permanent member of the United Nations (UN) Security Council.<sup>167</sup> In a more current example of Chinese Internet users' influence over the way China relays its foreign policy, Dr. Downs testified about the prominent news and Internet coverage of the recent Chinese evacuation of its citizens from Libya. The Chinese response to the crisis in Libya contrasted greatly with China's response to the kidnapping and murder of Chinese citizens in Ethiopia in 2007, which elicited sharp criticism of the government from Chinese Internet users for not coming to the aid of Chinese citizens. Dr. Downs asserted that the reason for the enhanced coverage of the Libya evacuation was to prevent the same type of backlash from Chinese Internet users that arose in 2007.<sup>168</sup>

Nevertheless, these voices are severely limited by China's propaganda apparatus, which aggressively censors online material that is deemed inappropriate. As a result, often the only voices that are left on the Internet are those that already coincide with the opinions of Beijing's elite. Dr. Chen testified:

*It is hard to establish a link between online pressure and the government's foreign policy. It is more appropriate to say that policymaking elites can entertain online expression of interests, picking and choosing the ones they see as being most beneficial for the execution or conduct of foreign affairs.*<sup>169</sup>

### **Coordination of Foreign Policy Actors under the CCP**

The proliferation of voices in Chinese foreign policy has made coordination among actors difficult in recent years. Often, in any given country, Beijing must manage the activities of the ministries of Foreign Affairs, Commerce, Finance, Agriculture, Health, and the Export Import Bank of China and China Development Bank. On top of that, companies, provincial governments, and research institutions are launching their own relationships with specific nations. Ms. Lawrence noted, "[m]any of the Chinese players ... now

do not answer to the Foreign Ministry, and do not necessarily feel compelled to coordinate their activities with it.”<sup>170</sup> Difficulties can arise when two ministries conflict with one another in carrying out China’s foreign policy, because they are both seated at the same bureaucratic level.<sup>171</sup>

In some cases, a lack of coordination among China’s various foreign policy actors threatens to upset Beijing’s foreign policy goals. For example, in the South and East China Seas, there are at least six distinct official actors operating, including China’s five civilian maritime administration and security agencies and the PLA Navy. In testimony to the Commission, Stacy A. Pedrozo, a U.S. Navy captain and military fellow at the Council on Foreign Relations, noted that China’s various maritime actors are insufficiently coordinated, posing a threat to the peaceful resolution of disputes in the region.<sup>172</sup> Chinese officials acknowledge this problem as well and have announced plans to enhance central coordination of actors in the South China Sea in the future.<sup>173</sup> A lack of coordination between Chinese government ministries and state-owned weapons manufacturers may also have led to a strain in Sino-Libyan relations in 2011. A Canadian newspaper discovered evidence that three Chinese state-owned companies offered to sell \$200 million in weapons to pro-Qaddafi forces in June in violation of a UN embargo on arms sales to Libya. Chinese Ministry of Foreign Affairs officials denied prior knowledge of the negotiations, and some analysts suggested that the state-owned weapons manufacturers may have bypassed the Ministry of Foreign Affairs and instead dealt directly with the Qaddafi government.<sup>174</sup>

Despite problems of coordination, there is little dispute that the CCP still holds firm control over China’s foreign policy. Although many of the groups involved have access to the political elite in the Communist Party, Dr. Chen testified that “[i]n the end, it is [CCP] decision-making elites who can define and determine which groups can exist and enter the foreign policy-making process.” Ultimately, the top leadership, namely President Hu and the Politburo Standing Committee, are the definitive architects of Chinese foreign policy.<sup>175</sup>

### **Implications for the United States**

The increasing number of voices in Chinese foreign policy-making requires U.S. diplomats and leaders to be adept in identifying which individuals and organizations are influential and where they fall in the Chinese foreign policy-making apparatus while ensuring that they are mindful of the opinions of nontraditional actors as well. As China’s foreign policy actors grow in number and diversity, the direction and intention of China’s foreign policies may become more difficult for U.S. policymakers to calculate. Dr. Shambaugh notes, “[t]he fact that China has such a diverse discourse suggests that it possesses multiple international identities and a schizophrenic personality.”<sup>176</sup> This can complicate how the United States formulates its policies vis-à-vis China and can lead to misperceptions of what each country’s true intentions are. For example, if U.S. leaders exclusively paid attention to the hard-line voices coming out of the PLA, they might be inclined to react to what they perceive is a more aggressive China. During the Com-

mission's December 2010 trip to Singapore, Commissioners heard from the Singaporean Ministry of Foreign Affairs about its frustration with the number of different voices coming out of Beijing, making it difficult to know whether specific Chinese officials' opinions are authoritative.

Although the increasing number of players involved in China's foreign policy-making process may make U.S. policy responses more difficult to coordinate, it could provide U.S. diplomats with multiple channels to engage China's policymakers on important issues. While the Ministry of Foreign Affairs remains the primary point of contact for U.S. officials, the proliferation of other foreign policy players in China could expand opportunities for the United States to pursue a more sophisticated understanding of China's foreign policy process.

### **Conclusions**

- As China expands and diversifies its overseas activities, it encounters an increasingly complex environment requiring the input and advice from knowledgeable subject matter experts. As a result, China's foreign policy-making process is changing to accommodate input from actors who previously had little or no say.
- Actors with increasing influence on China's foreign policies include the PLA, large state-owned enterprises, and academics and think tanks. In addition, while still minor compared to other actors, public opinion, expressed primarily online, appears to have a modicum of influence on some Chinese foreign policies.
- The CCP remains firmly in control of China's foreign policies, especially for issues deemed critical, such as China's policies toward the United States, North Korea, and Taiwan. This is despite the increased difficulty Beijing may have in coordinating a coherent policy among a growing number of actors.
- The growing complexity of China's foreign policy-making process has mixed implications for the United States. On the one hand, Washington may find it more difficult to interact with priority counterparts in Beijing as the number of actors in the policy process expands. On the other hand, the plethora of Chinese actors may provide U.S. foreign policymakers with opportunities to understand or influence Beijing.

## RECOMMENDATIONS

### *An Overview of China's Relations with North Korea and Iran*

The Commission recommends that:

- Congress investigate whether U.S. sanctions have been imposed on all Chinese firms that have violated the sanction laws by investing in Iran's petroleum industry or providing Iran with refined petroleum products or advanced conventional weapons.
- Congress, in light of China's continued investments in North Korea, hold hearings to evaluate the effectiveness of expanding North Korean sanctions to cover foreign firms investing in North Korea's natural resource industry.

### *Actors in China's Foreign Policy*

The Commission recommends that:

- Congress investigate the extent to which the People's Liberation Army is becoming a more influential actor in China's foreign policy-making.
- Members of Congress make an effort to engage with multiple official and unofficial foreign policy actors during their trips to China in order to better understand and establish channels of communication with these actors.

### *Taiwan*

The Commission recommends that:

- Congress urge the administration to sell Taiwan the additional fighter aircraft it needs to recapitalize its aging and retiring fleet.
- Congress request from the administration an update on the Taiwan submarine program that was approved for sale by the U.S. government in 2001.
- Congress explore in hearings the implications for the United States and the region of closer China-Taiwan relations.

### *Hong Kong*

The Commission recommends that:

- Congress reauthorize Section 301 of the Hong Kong Policy Act of 1992, which requires the U.S. secretary of State to submit an annual report to Congress on political, social, and economic developments in Hong Kong as they relate to the United States. This

should include reporting on China's measures to use Hong Kong as a platform for the internationalization of the renminbi.

- Members of Congress, when visiting mainland China, also visit Hong Kong and that Congress encourage senior administration officials, including the secretary of State, to make visits to Hong Kong part of their travel.
- Congress encourage its Members to raise the issue of preserving Hong Kong's special status when meeting with members of China's National People's Congress.



<b>Selected CAIFC/CPD Track Two Exchanges with Government Officials and Think Tank Scholars in 2009–2010</b> <sup>143</sup>	
<p>In addition to activities that it sponsors directly, the Chinese Association for International Friendly Contact also operates its own associated think tank, the Center for Peace and Development (CPD).<sup>144</sup> Not counting the extensive number of programs run by other Chinese organizations, the CAIFC and CPD conduct a very active list of exchanges. A list of selected exchanges sponsored by CAIFC and/or CPD from the years 2009–2010 includes the following:</p>	
Dates	Participating Foreign Organization(s)/Person(s) and Issues Discussed (If Known)
June 27– July 9, 2010	A delegation from CAIFC meets in Washington, DC, with Members of Congress and representatives of the Asia Society and the Center for Strategic and International Studies, among others. They also meet in New York with faculty at Columbia University. Topics discussed reportedly focused on U.S and Chinese policy in Central Asia.
June 15, 2010	CAIFC hosts a visit to China by the governor of Hawaii and an accompanying delegation from the Hawaii Chamber of Commerce.
April 4–13, 2010	CAIFC sponsors a delegation of five former Members of Congress to visit China; in Beijing, they visit the National People’s Congress, the Ministry of Foreign Affairs, the Ministry of Commerce, and the People’s Bank of China.
November 25, 2009	CPD hosts a visiting delegation from Britain’s Royal United Services Institute for Defence and Security Studies. Topics discussed reportedly included Chinese-European relations, Afghanistan, and the Iranian nuclear program.
October 16– 24, 2009	In the second round of meetings of the “Sanya Initiative,” <sup>145</sup> a delegation of retired Chinese generals visits the United States. They visit U.S. Pacific Command headquarters in Honolulu; and subsequently travel to Washington, D.C., where they meet with Secretary of State Hillary Rodham Clinton, Vice Chairman of the Joint Chiefs General James Cartwright, and members of the China Working Group caucus of the U.S. House of Representatives.
May 19, 2009	CAIFC representatives, including former Foreign Minister Li Zhaoxing, entertain a visiting delegation of senior-ranking retired Japanese military officers at the Diaoyutai Guest House in Beijing.
May 15, 2009	Hosted by CAIFC, a delegation from the Asia-Pacific Center for Security Studies visits the Ministry of Foreign Affairs, the China Institute of International Studies, the Chinese Academy of Social Sciences Institute of American Studies, and Qinghua University.
April 8–18, 2009	A delegation of CAIFC representatives travels to Washington State to meet with state political and business leaders and subsequently to Washington, DC, for discussions at The Brookings Institution and the Center for Strategic and International Studies.

Despite concerns raised by the sponsorship role of Chinese intelligence and Communist Party-controlled entities—and their role as conduits for propaganda messages targeted at foreign elites—many U.S. participants involved with track two exchanges have emphasized the value of dialogue with PRC state-controlled think tanks and other like bodies, noting that these discussions offer insights into the policy positions favored by the government parent organization.<sup>146</sup> In testimony before the Commission this year, Abraham

upon their preparedness for potential Chinese counterspace activities. To the extent that commercial entities provide essential services, assessments should also cover their systems.

30. Congress assess the adequacy and regularity of U.S. military exercises and training activities that simulate the destruction, denial, degradation, or manipulation of U.S. space assets. In addition, Congress should periodically evaluate whether the Department of Defense is taking sufficient measures to diversify its traditionally space-oriented capabilities, such as in navigation, communications, intelligence, surveillance, and reconnaissance.

### **Chapter 3: China's Foreign Policy**

#### ***Section 1: An Overview of China's Relations with North Korea and Iran***

The Commission recommends that:

31. Congress investigate whether U.S. sanctions have been imposed on all Chinese firms that have violated the sanction laws by investing in Iran's petroleum industry or providing Iran with refined petroleum products or advanced conventional weapons.
32. Congress, in light of China's continued investments in North Korea, hold hearings to evaluate the effectiveness of expanding North Korean sanctions to cover foreign firms investing in North Korea's natural resource industry.

#### ***Section 2: Actors in China's Foreign Policy***

The Commission recommends that:

33. Congress investigate the extent to which the People's Liberation Army is becoming a more influential actor in China's foreign policy-making.
34. Members of Congress make an effort to engage with multiple official and unofficial foreign policy actors during their trips to China in order to better understand and establish channels of communication with these actors.

#### ***Section 3: Taiwan***

The Commission recommends that:

35. Congress urge the administration to sell Taiwan the additional fighter aircraft it needs to recapitalize its aging and retiring fleet.
36. Congress request from the administration an update on the Taiwan submarine program that was approved for sale by the U.S. government in 2001.
37. Congress explore in hearings the implications for the United States and the region of closer China-Taiwan relations.

## ADDITIONAL VIEWS OF COMMISSIONERS WILLIAM REINSCH AND ROBIN CLEVELAND

We support this year's report despite our opposition to several of its recommendations because we think it adequately captures many of the dilemmas and difficulties that currently beset our relationship with China. At the very time our own country is faced with a vast range of difficulties and appears divided on the correct solutions, we must also deal with a rising China that appears to have ignored or forgotten then-U.S. Trade Representative Robert Zoellick's call for China to be a "responsible stakeholder."

On the economic front, the report details the growing number of problems the U.S.—and other developed economies—has with China such as its indigenous innovation policy, its continued failure to adequately protect intellectual property, subsidies, barriers to market access, discriminatory regulations, and its undervalued currency.

It is clear that China has made a sharp turn in its economic policy over the past five years in the direction of more state control and less free market competition. This comes as a huge disappointment to the American business community which supported Chinese WTO accession as a means to integrating it into the Western market trading system. Ten years later evidence is piling up to suggest that China wants to enter the system solely on its own terms, even when they are incompatible with WTO rules or modern business practices. Many of these practices will be litigated in the WTO, where we will likely win, but the damage will by that time be done.

On the military front, the Commission has rightly focused much of its attention in this report on China's activities in the South China Sea and on its relations with North Korea and Iran. While its policies with respect to the last two are not helpful, they are also not new, and the Commission has commented on them in the past. In the South China Sea, China's vigorous assertion of its exaggerated claims has been a destabilizing force in the region that threatens to grow worse. Ironically, this has helped enhance an appreciation among the other littoral states for a strong U.S. presence there, to which we believe the Administration has responded skillfully.

China's military buildup, which we have commented on in past reports, continues, and a number of the Commission's recommendations have correctly focused on the adequacy of U.S. preparation for an enhanced Chinese presence and capability.

It is on the economic side where we believe the Commission's recommendations go astray. As we said last year in our additional views,

"The United States, recovering too slowly from the worst recession in 80 years, seems tempted to act out of fear, blaming China for our economic problems just as 20 years ago we blamed the Japanese. While blame is tempting—and often well-placed—it is *our* destiny we control, not theirs. Faulting them for doing things in their own interest is emotionally satisfying but ultimately an empty gesture. Our politicians serve our people best when they act

in our interests and when they persuade the Chinese to work with us in pursuit of common interests.”

This means that the right answers lie in policies we should pursue to make ourselves more competitive rather than policies to hold the Chinese back. Many of those policies lie outside the Commission’s mandate, not to mention its competence. However, our inability to provide the right answers does not mean that we should suggest the wrong ones instead.

One such wrong answer is the Commission’s recommendation on tracking Chinese investment in the United States. We already have a process for blocking investments that raise national security issues. Recently updated by the Congress, it appears to be working smoothly. No doubt, there will be proposed Chinese investments that will be blocked, but there are also investments that will bring jobs and economic growth to our country, and we should welcome those as a constructive means of returning some of the dollars that China has accumulated. The recommendation is only for reporting, but it encourages a climate of paranoia about Chinese activities here that does not serve us well economically and does not dignify us as a people.

Likewise, the Commission’s recommendations for a GAO study of U.S. firms’ operations in China and a report on possible procurement of Chinese goods and services through federally subsidized contracts will contribute to the same climate while providing little useful information.

These recommendations are not in and of themselves fatal flaws in our report, but they reflect a disturbing trend in our country towards economic nationalism that focuses on finding people to blame for our problems rather than on what we must do to solve them. While this report is hardly the worst example of this trend, the Commission has missed an opportunity to rise above it and emphasize constructive rather than confrontational solutions.

In the long run, a constructive approach will be required. China is in the process of assuming a global role commensurate with its size, potential, and aspirations. As it does so, it is in our interest, as well as China’s and everyone else’s, that it take on the obligations of leadership, which require a degree of self-abnegation. China’s leaders have demonstrated that they have a clear understanding of what is in their immediate interest. Their challenge will be to demonstrate they also understand what is in the larger interest of the global system of which they are a part, that the health of that system is inextricably tied with their own, and that they are prepared to act on that understanding. The Commission’s job is to continue to make that point.