

# CHINA: THE BALANCE SHEET

## WHAT THE WORLD NEEDS TO KNOW NOW ABOUT THE EMERGING SUPERPOWER

### MEETING THE CHINA CHALLENGE

American strategy can—and must—respond to China’s rise in a way that assures regional security, realizes the greatest possible economic benefit, averts worst-case outcomes from China’s remarkable social transformation, and increasingly integrates the country as a partner—or at least not an active opponent—in achieving a prosperous and stable world order for future generations. All this can be done—if the United States asks the right questions, understands China’s complexities, and reinforces America’s strengths. *China: The Balance Sheet*, a joint publication by the Center for Strategic and International Studies and the Institute for International Economics, provides the foundation for an informed and effective response to the China challenge in four critical areas.

### DOMESTIC ECONOMY

*China: The Balance Sheet* examines the sources of China’s spectacular economic growth, as well as its most troubling economic weaknesses. The book assesses whether China can continue to grow at such a pace, or whether it will overheat and collapse in the next spectacular case of failed development and financial mismanagement. (Chapter 2)

### DOMESTIC TRANSFORMATION

The book explores whether China’s remarkable domestic transformation will lead to more pluralistic and even democratic forms of government, or instead to widespread upheaval and unrest. It analyzes the Chinese leadership’s strategy for maintaining political control while orchestrating ever greater prosperity, and addresses the implications of various outcomes for U.S. interests. (Chapter 3)

### Project Overview

*China is becoming one of the most powerful countries in the world: too big to disregard and too critical to misread. As the 21st Century unfolds, the stakes have never been higher nor the need greater to get U.S. policy toward China right, and yet there is often more heat than light in the U.S. debate about China.*

*To address this pivotal issue, the Center for Strategic and International Studies (CSIS) and the Institute for International Economics (IIE) have launched a joint multi-year project that brings together leading specialists to examine the key questions, uncover the pertinent facts, and analyze the dynamics underpinning China’s domestic transformation and emergence as an international power—as well as its implications for the United States and the world.*

*China: The Balance Sheet* the project’s initial publication, provides the public and policymakers alike with comprehensive, authoritative and accessible analysis to have an informed debate and intelligent policy response to the challenge of a rising China — the world’s emerging superpower.



*China: The Balance Sheet: What the World Needs to Know Now about the Emerging Superpower*

Authors: C. Fred Bergsten, Bates Gill, Nicholas R. Lardy and Derek Mitchell

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## WORLD ECONOMY

*China: The Balance Sheet* explores whether China represents a major threat to American jobs, living standards, and access to energy and other vital commodities – or whether it is predominantly a beneficial driver of global economic prosperity, offering opportunities that outweigh the risks for businesses, workers, and consumers. The book assesses whether China's large holdings of U.S. financial assets endanger U.S. stability, and recommends what the United States should do to encourage China's emergence as a positive force in the global economy. (Chapter 4)

## FOREIGN AND SECURITY POLICY

The book analyzes China's foreign and security policy and explores its strategic intentions. Is China another pre-1914 or pre-1939 Germany? Imperial Japan? Soviet Russia? The book assesses whether China and the United States are destined to become enemies, or whether Beijing and Washington can realize, as they have in the past, a new strategic and mutually beneficial *modus vivendi*. (Chapter 5)

### Quick Facts

*China's economic modernization has lifted almost 400 million citizens out of poverty since 1990, but 415 million Chinese still live on less than \$2 per day.*

*China has one of the most open economies, but the country consistently rates as one of the politically least free countries in the world.*

*China is the world's fourth largest economy, but its per capita income is ranked around 100th in the world--the first "poor" global economic superpower in history.*

*China has increased its military budget by double digits every year since 1991, but says it pursues a "path of peaceful development to greater power."*

## CONCLUSIONS: TOWARD A NEW U.S.-CHINA RELATIONSHIP

Four fundamental conclusions for U.S. policy emerge in the book (Chapter 6):

- China clearly represents both an opportunity and a threat to the U.S. in economic and security terms.
- The extent to which China becomes either a challenge or an opportunity is not predetermined and will depend greatly on the policy choices and internal dynamics of China and the U.S. in coming years.
- While U.S. influence over China should not be overstated, U.S. policy can play a role, for good or ill, in shaping the decisions China makes about its future.
- While a responsible strategic approach toward China must include preparation in U.S. domestic, foreign, and defense policies to deter and deflect Chinese actions that are contrary to U.S. interests, the United States has an overriding stake in effectively integrating China into the global economic and security systems in a way that reinforces the American people's long-term security, prosperity, and peace.

# CHINA: THE BALANCE SHEET

## GROWTH PROSPECTS

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- China has been the **world's fastest-growing economy for almost three decades, expanding at an average pace of almost 10 percent annually.**
- **China is now the world's fourth largest economy** (measured in dollars at current exchange rates) and third largest trader.
- Given its large size, rapid growth, and extraordinary openness to international trade, **it has already become a major source of global economic growth.**
- China's future global role, in both economic and strategic terms, will be heavily conditioned by its economic growth trajectory.

### CURRENT SITUATION

- What have been the sources of growth, and are these likely to persist? **Five key factors underlie China's growth: the embrace of market forces, the opening of the economy to trade and inward direct investment, high levels of savings and investment, the structural transformation of the labor force, and investments in primary school education.**
- *Embrace of market forces*  
**Over the first two decades of economic reform, market forces displaced long-standing nonmarket institutional arrangements.** The share of output allocated through the plan fell sharply, and market-determined prices replaced those of the planning authorities for all but a handful of goods and services. In urban areas, job assignment by the state at a fixed wage structure was replaced by a market in which individuals competed for jobs, wages were flexible, and labor turnover was considerable.

For further information, see Chapter 2:

“China's Domestic Economy: Continued Growth or Collapse?”

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## GROWTH PROSPECTS

- **Progress toward market allocation of investment resources has been slower than for goods and labor**, but the role of the budget in financing investment has declined precipitously and banks are in transition to a commercial orientation in which loans are extended on the basis of expected returns rather than political guidance. Stock and corporate bond markets, however, provide only a small share of investment funds for business expansion.
- Nonetheless, the reform of goods markets has had a positive indirect effect on capital allocation. This is because retained earnings of companies are the single largest source of investment funds and, **in contrast to the early years of reform, productivity and profitability are now highly correlated**. More efficient firms are more profitable and can expand more rapidly, while less efficient firms have lower profits and, on average, grow more slowly or go bankrupt.
- *Opening to global trade and investment*  
China has become increasingly open to the global economy, leading to a marked increase in competition. **Trade liberalization has made China one of the most open economies in the developing world**. Imports are almost a third of GDP, much higher than in the United States, and domestic firms also must compete with large quantities of goods produced and sold by foreign firms in China.
- *High levels of savings and investment*  
**Levels of savings and investment are much higher than in other developing countries at comparable levels of per capita income**. This has allowed an exceptionally rapid growth of the capital stock, adding to the economy's productive capacity.
- *Structural transformation of labor force*  
The share of China's labor force employed in agriculture has declined from 70 percent at the outset of reform to about 50 percent today. Output per worker in manufacturing and services on average is 16 times that in farming. So, **as workers leave agriculture, major productivity gains ensue**.
- *Investment in education*  
Investments in primary school education meant that, on the eve of reform, China had a relatively high literacy rate for a very low-income country, and the government further emphasized mass literacy by increasing mandatory education from five years to nine in 1986. **Basic literacy has been a crucial prerequisite to the creation of a relatively productive workforce in China's large and rapidly growing manufacturing sector**.  
Over the next decade, each of these factors should continue to contribute positively to China's economic growth:
- China's WTO commitments are further enhancing the role of the market, particularly in financial, distribution, and other services—domains where the introduction of market forces had lagged compared to the goods and labor markets.
- High levels of household savings are likely to persist for another decade, and the share of the labor force still in agriculture will continue to shrink.
- Finally, China is likely to continue to emphasize investments in education.

## IMPLICATIONS

- Looking ahead for the next five to ten years, **it would be prudent for the United States to base its own strategy on the assumption that China will continue to grow rapidly** and become an ever more significant factor in the global economy.
- **A significant economic slowdown for several years or even a collapse cannot be entirely ruled out**, but the strong likelihood is that China's leadership will undertake the further reforms necessary to sustain its rapid economic growth.

# CHINA: THE BALANCE SHEET

## CONSUMPTION-LED GROWTH

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- Over the past few years, China's economic growth has become increasingly dependent on increases in investment and net exports.

### CURRENT SITUATION

Policies for consumption-led growth:

- **The usual path to increased consumption is fiscal stimulus in the form of tax cuts on household income.** This avenue is of limited relevance in China, where direct taxes on households are only 1 percent of GDP.
- **The alternative form of fiscal expansion is an increase in government expenditures.** Given already high levels of investment and the emergence of excess capacity in many industries, however, the Chinese government needs to increase its noninvestment outlays, notably those on health, education, welfare, and pensions – those programs on which government at all levels currently spends only about 3.5 percent of GDP.
- In the short run, however, success may be hard to achieve. First, **since current noninvestment expenditure is so low, even dramatic proportional increases would stimulate economic growth only modestly.** Second, quantum jumps in such expenditures may not be feasible, at least not right away.
- **Increases in China's private consumption expenditure will thus disproportionately depend on reducing the extraordinarily high savings rate of households,** which has been running at about 25 percent of disposable income since 2000.

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## CONSUMPTION-LED GROWTH

- Yet, this is a formidable task in China, because the motivation for household savings seems primarily precautionary. **Only about one-seventh of the population, for example, is covered by basic health insurance, so many households save to cover medical expenses.** Families also save for retirement because the basic pension scheme covers only about 16 percent of the economically active population -- and in any case provides a pension equal to just 20 percent of average wages. Finally, **households save for education. Primary school fees are a large financial burden, particularly for poorer rural households.**
- **In the long run, as families gain confidence in the government's provision of health, education, and other social services, they may reduce their own savings voluntarily,** i.e. increase consumption as a share of their disposable income. Thus, the transition to a more consumption-driven growth path will probably need to start with increased government consumption expenditures, but with time is likely to be reinforced by changes in household consumption and savings decisions.

### IMPLICATIONS

- China emerged in 2004-2005 as one of the largest global surplus countries—and thus has become, along with the United States, a major source of global economic imbalances.
- Parallel actions by China and the United States, respectively the most important countries with unusually high and low savings rates, could significantly reduce these imbalances.
- **If China's households reduce their savings rate, China's current account surplus will decline.** This adjustment should be facilitated by an appreciation of the Chinese currency, which would mitigate the inflationary pressures that otherwise might emerge as savings' share of income falls and the share of consumption rises.
- Meanwhile, **there would need to be a simultaneous upward adjustment of the U.S. savings rate -- either through a reduction of the federal government fiscal deficit or an increase in household savings.** The latter would most likely result from a cooling of the housing market, which has fueled high consumption expenditures in recent years.

### Investment vs. Consumption in China

- *As early as December 2004, the Chinese Communist Party recognized the need to adjust the relationship between investment and consumption as sources of economic growth.*
- *In mid-2005, the central bank refined this theme, arguing that investment growth needed to slow further to allow demand to catch up with supply in sectors such as steel, aluminum, cement, real estate, and even electric power, where excess capacity was evident or predictable.*
- *The bank also doubted the sustainability of rapid net export growth, if for no other reason than the likely rise of foreign protectionism, and concluded that China needed to transition to a more consumption-driven growth path .*
- *This objective has since been reprised in a number of important government documents, most notably the Outline for the Eleventh Five-Year Program, approved by the Party's Central Committee in October 2005.*
- *While it may take time, such a transition would be a welcome development for the United States and the global economy.*

# CHINA: THE BALANCE SHEET

## ENERGY

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- China is poorly endowed with natural resources, with the exception of coal.
- This lack of resources, combined with rapid sustained growth, has caused **China to become increasingly dependent on imports of petroleum and other natural resources.**
- **China's energy consumption grew 80 percent in 1995–2005**, and its share of world energy consumption increased from 9 percent to 12 percent.
- **China has been the world's number two oil consumer after the United States since 2002** and now relies on imports to meet almost half of its demand for oil.
- According to the International Energy Agency (IEA), **China accounted for under a tenth of global petroleum demand, but accounted for slightly more than one third of incremental world oil consumption between 2002 and 2004**, contributing materially to upward price pressure in global markets.
- Similarly, **China is the world's leading importer of iron ore, aluminum, and paper and pulp**, and drives marginal global demand growth for copper, steel, and cement.
- China continues to rely on the Middle East for almost half of its oil imports, although in recent years, **Beijing has sought to diversify the types and sources of energy supply**—particularly through gaining control of energy production assets or acquiring stakes in overseas energy companies.

### CURRENT SITUATION

- Difficulties faced by Chinese companies in acquiring mainstream energy companies, such as CNOOC's controversial bid for Unocal in 2005 (see box), have fueled China's search for energy assets along its periphery, and in countries where Western companies have limited access due to self-imposed sanctions for human rights and other reasons, such as in Sudan, Angola, Burma, and Iran.

For further information, see Chapter 2: "China's Domestic Economy: Continued Growth or Collapse?" and Chapter 5: "China's Foreign & Security Policy: Partner or Rival?"

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# ENERGY

- These energy deals have proceeded in tandem with diplomatic initiatives, humanitarian aid and assistance, infrastructure investment, and cooperation in international organizations. For example, **China's reluctance to refer Iran's nuclear ambitions to the UN Security Council for action or permit humanitarian intervention in the Darfur region of western Sudan is linked to its growing energy dependence on both states.**
- **Ninety percent of China's imported oil is transported by ocean-going tanker;** 80 percent of China's oil imports transits through the Strait of Malacca alone, a major potential chokepoint.
- As a result, China has sought to develop new port facilities, such as in Pakistan at Gwadar, Bangladesh, and Burma, and more overland pipelines extending from South, Southeast, Central, and Northeast Asia.
- Aside from the risk of collisions, piracy, and terrorist attacks, China's oil tankers are dependent on the U.S. Navy to patrol and secure these sea lanes, which China views as a strategic vulnerability should U.S.-China relations turn sour. Energy security is one rationale behind China's efforts to upgrade its naval capacity.

## IMPLICATIONS

- **The supposition that fundamental U.S. and Chinese interests diverge on global energy issues is profoundly incorrect.**
- **Both the United States and China are large net energy importers and thus share an interest in a stable Middle East,** increased global investment in oil and natural gas production, and the development of economically viable alternative energy technologies.
- **China's ownership of foreign oil and gas assets need not adversely affect U.S. interests.** In the long-run, Chinese firms are likely to invest at least as much as alternative owners in expanding oil and gas production in foreign locations, which, of course, benefits the United States and all other energy importing countries.
- **In the short run, however, there is an important divergence of interests as China thwarts U.S. efforts to impose economic sanctions on Sudan and Iran, for example.** Concerns over China's expanding naval ambitions also have the potential to undermine U.S.-China cooperation on energy, and lead to suspicion and rivalry in U.S.-China relations.
- **These challenges should be managed so the two countries can work together to meet their common energy objectives,** which importantly include increasing energy efficiency and conservation. Cooperation would be facilitated by China's full membership in the IEA .

### Energy Efficiency and Pricing

*China has made substantial progress toward increasing energy efficiency as it gradually raised the domestic price of crude oil and refined petroleum products starting in the late 1980s.*

*By June 1998, convergence of domestic and international prices was complete when China adopted a formal policy of pricing domestic crude oil at the international price and not allowing any price subsidies for refined petroleum products sold at the retail level. When global crude oil prices began to rise sharply in 2004, however, the government partially abandoned this policy. As a result, refined product prices in China in late 2005 were the lowest of any major global economy – roughly one-third below U.S. levels, which by a wide margin are the lowest of any advanced industrial economy.*

*China is unlikely to continue on its long-term trajectory of increased energy efficiency unless it ends its policy of partially insulating domestic consumers of refined products from higher global prices.*

### CNOOC's Bid for Unocal

*In 2005, the China National Offshore Oil Corporation (CNOOC) bid to purchase the American oil company Unocal. U.S. critics charged that the transaction would make the United States more dependent on foreign oil and thus harm U.S. interests. This charge, and the fear that China's energy investments elsewhere are allowing it to "lock up" long-term supplies, reflect a fundamental misunderstanding of the global energy market.*

*Had China acquired Unocal and diverted its entire output to China, the net effect on the United States and the global markets for oil and natural gas would have been negligible. For every unit of oil or natural gas China imported from Unocal fields, it would import a unit less from other sources, so the net effect on the global energy market would be nil.*

*China's impact on the global markets for energy depends on the pace of its domestic growth and the efficiency with which it uses energy.*



# CHINA: THE BALANCE SHEET

## SOCIAL UNREST AND NATIONAL STABILITY

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- The incidence of unrest in China has risen dramatically – from about **8,700 protests and other major public disturbances in 1993 to 87,000 in 2005**.
- Protests are growing in average size from 10 or fewer people in the mid-1990s to about 52 people per incident in 2004.
- **In the first half of 2005, there were over 340 protests involving more than 10,000 people**, resulting in an estimated economic loss of \$4.2 billion to \$5 billion.
- Between January and October 2005, 1,826 police were injured and 23 killed while handling “mass group incidents.”
- In urban areas, sources of unrest include unfair working conditions in enterprises; lack of social security for laid-off workers; unpaid pensions for retired workers of state-owned enterprises; low and unpaid wages for migrant workers; insufficient compensation for resettled urban residents; and ethnic tensions.
- In rural areas, where the frequency and scale of incidents are greater, unrest arises largely from shady land confiscation, fees, tolls and other local tax burdens, environmental degradation, and official corruption.

### CURRENT SITUATION

- The central leadership is acutely aware of the challenges posed by social unrest and has recently announced a slew of **new policies aimed at addressing social welfare issues, especially in the countryside**.

For further information, see Chapter 3:

“China’s Domestic Transformation: Democratization or Disorder?”

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# SOCIAL UNREST AND NATIONAL STABILITY

- **The authorities have adopted a somewhat more permissive and sophisticated strategy to deal with protests, even supporting them on occasion:** In April 2005, Premier Wen Jiabao reportedly called a halt to construction of a dam on the Nujiang River in Yunnan Province amidst widening public outcry against the project.
- That said, China has not “gone soft” on unrest: In the most troubling and persistent cases, **local authorities will intimidate or arrest individuals deemed to be “ringleaders” as a way to suppress further protests.**

## IMPLICATIONS

- While incidents of unrest are frequent and widespread—and clearly worrisome to Chinese leaders—they remain largely spontaneous, unorganized, and focused on localized “backyard” grievances. **They do not appear to threaten the stability of the regime for the near to medium term nor are they likely to lead to the democratization of the country.**
- **The vast majority of protests do not promote broader political reforms** nor do they appear to be linked through any national network or other coordinating mechanism of dissent.
- **Chinese authorities will, however, continue to crackdown at the first sign of any association among leaders and organizations on a national level**, such as against Falun Gong and the China Democracy Party.

### Recent Incidents of Unrest in China

*October 2004: A clash between Han Chinese and Hui minorities in Henan Province involving more than 10,000 people left 100 dead, including 15 police, and 400 injured.*

*November 2004: To protest layoffs, workers at one factory in Dongguan, Guangdong Province, took their bosses hostage, and workers at another factory in the same town fought with security guards.*

*April 2005: In Huaxi, Zhejiang Province, some 60,000 farmers erupted in anger over local government indifference to health problems caused by nearby chemical plants. Two people were reported killed.*

*December 2005: In Dongzhou Village, Guangdong Province, local police opened fire during a confrontation with some 300 villagers protesting construction of a local power plant; 20 people were reportedly killed.*

*January 2006: A Chinese farmer detonated a bomb in a court house in Gansu Province, killing himself and four others and injuring 22 people. The farmer was protesting a court ruling over a land dispute.*

# CHINA: THE BALANCE SHEET

## CORRUPTION

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### BACKGROUND

- **In tandem with stellar economic growth, corruption has increased dramatically in China.** According to Transparency International's Corruption Perceptions Index 2005, China scored a 3.2 on a scale of 1 to 10, with 10 being least corrupt — ranking 78th out of 158 countries surveyed, on a par with Laos and Sri Lanka.
- Since 2002, some **30,000 officials have been found guilty of corruption**, affecting 32 government agencies.
- In March 2005, it was disclosed that:
  - 11 senior-level government officials were among the 2,960 undergoing investigation for corruption.
  - 170,850 Party members were also being investigated, including 16 provincial officials and 432 at or above the prefecture level.
  - A total of 345 procurators and 461 judges were also convicted and punished for graft offenses in 2004.
- In the financial sector, **China punished more than 1,600 employees of financial institutions** in the first half of 2005 for fraud and other related crimes. Of these, 570 managers and branch heads have been imprisoned or fired.
- **Corruption is also rife in the construction and real estate sectors**, where huge investment in new infrastructure projects creates numerous opportunities for corruption and where the shady requisition of land for such projects has become a major source of growing social unrest in rural China.

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# CORRUPTION

## CURRENT SITUATION

- **The central authorities have repeatedly attempted to clamp down on corruption in recent years, including through high-profile convictions** — beginning in 1995 with former Politiburo member Chen Xitong.
- A series of anti-corruption campaigns, even including an old-style rectification movement aimed at addressing the general “moral degeneration” of Party members, has been launched to address the problem.
- Survey evidence shows that public satisfaction with the anti-corruption drive increased from 33 percent in 1996 to 52 percent in 2003.
- Yet lack of enforcement continues to stymie the central authorities’ anti-corruption efforts, especially at local levels.
- **Corruption persists because officials and powerful businesspersons can get away with it:** The Chinese political and legal system lacks across-the-board accountability, checks and balances, competency (let alone independence), and even a quasi-independent anti-corruption agency.
- More broadly and troubling, the main causes of corruption may be structural, arising from the economic distortions as society shifts from a state-centric to a more market-oriented system.
- More worrisome still is the possibility that corruption is so deeply engrained and lucrative that occasional enforcement campaigns are not sufficient to build the necessary “ethics infrastructure,” but are rather purely political efforts to portray the Party as “doing something.”
- Although economic losses corruption causes are astonishing— as high as an estimated \$84.4 billion or 5 percent of GDP—China’s economy pays little price and foreign direct investment continues to pour in; FDI for 2005 amounted to \$60.3 billion.

### Notable Corruption Cases

*April 1995: Former Beijing Party secretary and Politiburo member Chen Xitong investigated for corruption; Vice-Mayor Wang Baosen committed suicide just before the scandal erupted.*

*September 2000: NPC Vice Chairman Cheng Kejie executed for taking bribes amounting to \$5 million.*

*March 2005: China Construction Bank (CCB) Chairman Zhang Enzhao resigned after reportedly receiving \$1 million in kickbacks from a U.S. software company.*

*December 2005: Former Minister of Land and Resources Tian Fengshan convicted of taking \$545,000 in bribes.*

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*“Corruption damages the interests of the people and the close links between the Party and the people, weakens the governance base and capability of the Party, affects social stability and disturbs the general situation of reform, development and stability.”*

*— Premier Wen Jiabao, February 2005*

*“All officials are corrupt, but as long as they can do some good for the masses, then we can forgive them.”*

*— Local’s comment on the sentencing of Shenyang Mayor Ma Suixin for corruption, August 2002*

## IMPLICATIONS

- The Party’s inability to control corruption has undoubtedly damaged its reputation; however, the problem does not yet pose an imminent threat to the Party’s ruling status.
- The central leadership, with its open appeals to combat corruption, has been largely successful in casting itself as an opponent of corruption and defender of the “little guy” who bears the brunt of local-level malfeasance.
- This approach can probably be sustained as long as economic prospects are good for the majority of citizens, the Party continues its high-profile anti-corruption campaigns, and disgruntlement arising from official wrongdoing remains localized and contained.

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## POPULATION AND DEMOGRAPHICS

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### BACKGROUND

- China's population of 1.3 billion is an implacable burden for the country's political, social, and economic development. **Keeping such a sizable population fed, clothed, sheltered, and generally satisfied consumes enormous resources.**
- Beyond the sheer enormity of China's populace, certain other population and demographic trends, such as **internal migration, aging, and a skewed gender ratio, have a multiplier effect in exacerbating China's host of socioeconomic challenges.**

### CURRENT SITUATION

- China's National Population and Family Planning Commission reported that the number of **internal migrants increased from about 53.5 million in 1995 to more than 140 million in 2004 and would continue to grow for the near term.**
- **Migrant workers today account for 20 percent of China's working-age population** (15–64 years old). Yet, according to the United Nations' projections, China's working-age population will peak around the year 2015 and then start shrinking.
- Despite the fact that only 11 percent of China's present population is over 60, the United Nations projects that **the proportion of elderly will increase to about 28 percent in 2040, by which time more than a quarter of the world's elderly population will live in China.**

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# POPULATION AND DEMOGRAPHICS

- According to China's 2000 national census, **the country's male to female sex ratio increased to roughly 117 males for every 100 females, whereas the global norm at birth is 105 boys to 100 girls.** The skewed gender ratio results from the one-child policy, the traditional preference for a male child, advances in sonogram technology to determine the sex of a fetus, and widespread availability of abortion in China (sex-selective abortion is illegal in China, but occurs nonetheless).

## IMPLICATIONS

- Rural-to-urban migration is a double-edged sword for China. Migration enables surplus rural labor to find urban jobs and accumulate savings, and areas that employ migrant workers benefit from a ready supply of cheap labor. However, large-scale migration rapidly increases the rate of urbanization in China. **In January 2006, the State Council, recognizing emerging challenges, passed new guidelines on the protection of rural migrant workers' rights, including timely wage payment and provision of education to their children.**
- **China has yet to develop a successful and well-funded pension system, and hence the great majority of Chinese continue to rely on the traditional form of old-age insurance: children.** Ten years from now, as China's baby boomers begin to retire, the first single-child generation will assume the burden of caring for the elderly.
- In terms of absolute numbers, with 134 million people above the age of 60, **China already has the world's largest elderly population.** That figure is likely to hit about 397 million by mid-century.
- **Because of the skewed male to female ratio, experts estimate that China will be home to as many as 30 million single men by 2020.** This surplus male population could result in an increase in crime, the sex trade, and bride trafficking—and, potentially, could further complicate adequate provision of elder care in a society where daughters-in-law are typically relied on to take that responsibility.

*Vast migrant worker "towns" are springing up on the edges of major cities where China's domestic challenges come together in microcosm: a weakening social safety net; environmental, health, and sanitation troubles; poverty; and rising levels of disaffection.*

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*"Unlike in the West and other developed economies, China will grow "old" before it becomes "rich."  
—Richard Jackson and Neil Howe, *The Graying of the Middle Kingdom: The Demographics and Economics of Retirement Policy in China*, April 2004*

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*China faces the starkest gender imbalance in the world. The increasing surplus of bachelors is potentially a source of social stress—for example, it could fuel the sex trade and the trafficking in brides from other Asian countries.*

# CHINA: THE BALANCE SHEET

## PUBLIC WELFARE

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- According to the World Health Organization, **the average life expectancy of people in China has risen from 35 in the 1950s to just over 71 in 2003.** The mortality rate of Chinese infants declined from as high as 20 percent during periods in the twentieth century to 2.5 percent at present. However, China's health system faces some serious challenges.
- **China's State Council Development Research Center announced that the country's medical insurance system currently covers less than half of urban residents** (approximately 100 million people) and only 10 percent of the rural population.
- United Nations' data show **the average level of per-capita health spending in urban areas was more than twice the national average** and 3.5 times the average health spending level in rural areas.
- According to the United Nations Development Program, **only 44 percent of China's population had "sustainable access to improved sanitation" in 2002**, and some 23 percent of the population in 2002 did not have sustainable access to improved water resources.
- According to data from the Chinese Ministry of Labor and Social Security and other estimates, in 2002, **only 55 percent of the urban workforce and 11 percent of the rural workforce were covered by China's public pension system.**

### CURRENT SITUATION

- **China's current health care and retirement systems do not provide a social safety net to replace the "iron rice bowls" that once guaranteed China's state-employed population with "cradle to grave" benefits**, including a modicum of preventative measures and health care treatment.

For further information, see Chapter 3:

"China's Domestic Transformation: Democratization or Disorder?"

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## PUBLIC WELFARE

- Today, private spending on health care as a percentage of GDP represents almost twice as much as public spending on health care.
- **China's medical resources have been mostly allocated to benefit urban areas**, while the lack of funding in rural areas means poor and declining health services over time.
- With an ailing public health care system, China is increasingly vulnerable to the spread of infectious diseases. **There are some 200 new HIV infections a day in China, with a total official estimate of 650,000 HIV-positive persons in China at the end of 2005.** Also in 2005, Chinese agriculture authorities reported 32 avian flu outbreaks in poultry in 12 provinces. As of February 2006, the Chinese Ministry of Health had announced 14 confirmed human cases, eight of which have been fatal.
- Meanwhile, chronic and non-communicable diseases are also a serious problem. **It is projected that China will lose \$558 billion over the next decade from premature deaths due to heart disease, stroke, and diabetes.**

*"China's medical reform has been unsuccessful because it has become unbearably expensive to patients and many dare not go to the hospital when they fall ill."*

*-- China's State Council Development Research Center, 2005*

*In some provinces, such as Yunnan, Henan, and Xinjiang, HIV prevalence rates exceed 1 percent among pregnant women, and among persons who receive premarital and clinical HIV testing, meeting the United Nations criteria for a "generalized epidemic."*

*With the central government cutting back on financial support to localities, poorer and rural parts of China are particularly hard-pressed to subsidize decent education, health care, and other social benefits.*

## IMPLICATIONS

- The challenge of an aging population, as well as the increase in chronic and infectious diseases, threaten to overwhelm an already deficient social welfare system.
- On the other hand, **the government's steady retreat from provision and oversight of social welfare activities has opened up new demand and social space for alternative, private-sector services and organizations**, such as business, entrepreneurs, and non-governmental organizations (NGOs) to fill this need.
- **Health NGOs are one of the largest and fastest growing NGO sectors in China, ranging from small, unregistered self-help groups to larger NGOs carrying out education projects, legal aid, advocacy or research.** Some health NGOs focus on specific groups—women, HIV/AIDS or cancer patients, children, and persons with disabilities—while others undertake projects to improve rural health care service.
- This civil engagement has led to a greater pluralization of Chinese society, a trend that looks likely to continue.



# CHINA: THE BALANCE SHEET

## THE ENVIRONMENT

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### BACKGROUND

- **China's economic explosion has created an ecological implosion**, threatening human health, industrial production, and crops.
- **Of the world's 20 most air-polluted cities, 16 are in China.** One of the principal sources of air pollution is linked to growing wealth: Auto emissions accounted for 79 percent of total air pollution in 2005. With cars becoming more affordable, the number of vehicles is likely to rise from 24 million today to 100 million by 2020.
- More than 75 percent of the surface water in urban areas is considered unsuitable for drinking or fishing; **90 percent of urban groundwater is contaminated**; and nearly 50 percent of river water is unsuitable for agriculture or industry.
- **Land degradation and deforestation are exacerbating floods and desertification**, as well as endangering the country's rich biodiversity.
- Pan Yue, the vice-minister of the State Environmental Protection Agency, stated frankly that **China's economic miracle is a myth**, since environmental degradation is costing the country nearly 8 percent of its annual GDP.

### CURRENT SITUATION

- In addition to rapid economic growth, the high investment rate, and the underpricing of energy, China's environmental problems are exacerbated by local government protectionism, insufficient government transparency, weak and understaffed environmental enforcement agencies, and a pervasive lack of mechanisms for informing and involving the public in environmental protection issues.

For further information, see Chapter 3:

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# THE ENVIRONMENT

- Recognizing this, the Chinese government has passed numerous laws and regulations on resource protection and pollution control as well as welcomed environmental assistance from bilateral and multilateral aid agencies and international NGOs. With international assistance, **China's environmental legislation has moved from a focus on command-and-control regulation to more progressive market incentive laws.**
- Energy shortages (nearly two-thirds of the country experienced brown outs in 2003–2004, though fewer in 2005) and growing air pollution have led the government to prioritize increased energy efficiency, use of renewable energy, and diversified energy sources. **The Eleventh Five-Year Program calls for improving energy efficiency by 20 percent by 2010.** The challenge of meeting these targets demands considerably greater investment and incentives as well as better enforcement of existing and future energy efficiency codes.
- International assistance is a major catalyst for the expansion of Chinese environmental NGOs. However, in other cases, **environmental activists have felt pressure from local officials who tend to crack down on activism perceived as threatening economic development.**

## IMPLICATIONS

- As the Chinese environmentalist Ma Jun has noted, time is not on China's side. **There is a narrow window for China's leaders to aggressively control the serious environmental threats facing the country.**
- **This is one area in which the United States and China can cooperate actively.** In the past 20 years, many international organizations have worked with the Chinese authorities to develop new environmental policies, regulations, and pilot projects. Besides the multilateral organizations (China is the biggest recipient of World Bank loans and grants for environmental work), bilateral aid and international NGOs have been very active in their "green" assistance to China.

### Confronting Environmental Unrest

*Between 1997 and 2004, new factories, housing, and shopping malls—which cater to the newly rich and often enrich local officials—have consumed about 5 percent of China's total arable land.*

*For farmers whose economic prospects have plummeted, land grabs and pollution from these new developments are often the last straw.*

*Villages along the Zhang River have been engaged in a decade-long resistance effort after a growing number of government-sponsored water diversion projects created a water shortage. Local governments were unable to resolve the conflicts, and a Ministry of Water Resources initiative has now been established to mediate.*

*When long-standing complaints regarding industrial pollution went unanswered by the local government, 60,000 farmers in Huaxi, Zhejiang Province took to the streets in April 2005. After police began beating people, the situation exploded and farmers from surrounding villages joined the fray; two people were reportedly killed. Local government promises to respond came to naught, and farmers have threatened new protests.*

*In the Three Gorges Dam area, periodic protests continue against the mismanagement of the resettlement process (insufficient compensation, force used against citizens to relocate, and local corruption). Even peaceful demonstrations are increasingly suppressed by force.*

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*Air pollution in China is responsible for between 300,000 and 500,000 premature deaths annually. And yet the government is planning 562 new coal-fired power stations by 2012 – nearly half the world's total.*

# CHINA: THE BALANCE SHEET

## POLITICAL REFORM

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### BACKGROUND

- In response to socioeconomic challenges, **the Party concedes the need for political reform to accompany economic reform.** Various measures are being implemented at the state, party, and grassroots levels.
- These measures are, however, purely instrumental and aimed not at reform per se, but at keeping the Party firmly in control and at maintaining its ruling status.
- **Up to 75 percent of rural Party organizations were reportedly in a “state of collapse” in the 1990s,** and other entities, including traditional clans, triads, and Christian churches, were stepping into the vacuum.
- State Reform: After pursuing decentralization in the 1980s, **concerns including the collapse of the Soviet Bloc, as well as local protectionism, corruption, and increasing unrest, provided the impetus for recentralization in the 1990s;** tax reforms adopted in 1994 helped improve Beijing's fiscal position vis à vis the provincial governments.
- Party Reform: **Promoting “inner-Party democracy” and accountability through institutionalizing Party procedures has been implemented.** Efforts to make procedures more transparent include media reporting on previously closed-door Party meetings.
- Institutionalization also aims to resolve one of the most persistent stumbling blocks for Communist parties: **leadership succession.** The transfer of power to the “fourth generation” leadership in 2002–2003 was the smoothest in Chinese Communist history.
- Grassroots Reform: Experiments are taking place across the country:
  - **Elections occur in almost one million villages, affecting about 80 percent of the**

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# POLITICAL REFORM

population in the countryside. More competitive elections have been elevated to some township governments.

- **Experiments with direct elections for “urban community residents committees” are being held in some places and other experiments are under way**, including the system of “democratic consultation,” in which citizens can freely express concerns on important issues during open meetings with local officials.

## CURRENT SITUATION

- **The Party continues to have success in co-opting China’s emerging “middle class” of entrepreneurs and intellectuals.** The Party recognizes the need to open the political system enough to retain legitimacy and support, but not so much that they lose power.
- **In a white paper issued in November 2005, the Party laid out its plan to build a “socialist democracy with Chinese characteristics.”** Rejecting post-Communist “shock therapies” of radical political reform, it borrows selectively from other systems for a so-called participatory democracy that combines authoritarian Party leadership, a modest expansion of popular participation, and governance through the rule of law, while eschewing universal suffrage, true parliamentary bodies, checks and balances, and contested multiparty elections.

## IMPLICATIONS

- As China moves toward a more open political system, it is unlikely to follow a Western-style path, at least in the near term. Research suggests that at present, there is no widespread public support for Western liberal democracy. Chinese academics debate the notion of a “democracy deficit,” pointing to the difficulties that have followed from its rapid introduction in places such as Russia, Indonesia, and Iraq.
- Over the near to medium term, the United States should be prepared to deal with a China led by the Chinese Communist Party. As such, while calls for a more open, just, and democratic China are an indispensable part of U.S.–China policy, they should be informed by realistic expectations.

*The Party leadership frankly noted that China had reached a “critical stage in which new situations and new problems are mushrooming” and warned that the ruling status of the Party “will not remain forever if the Party does nothing to safeguard it.”*

—Xinhua, September 26, 2004

### The Nine Men Who Rule China

Hu Jintao (63), *president; chairman of the CCP and Central Military Commission. Born in Anhui; engineer.*

Wu Bangguo (64), *chairman, National People’s Congress. Born in Anhui; engineer.*

Wen Jiabao (63), *premier. Born in Tianjin; geologist.*

Jia Qinglin (65), *chairman of the China People’s Political Consultative Committee. Born in Hebei; engineer.*

Zeng Qinghong (66), *PRC vice president; president of the Central Party School. Born in Jiangxi; engineer.*

Huang Ju (68), *vice premier. Born in Zhejiang; engineer.*

Wu Guanzheng (67), *secretary of the Central Discipline and Inspection Committee. Born in Jiangxi; engineer.*

Li Changchun (61), *Born in Liaoning; engineer.*

Luo Gan (70), *Born in Shandong; engineer.*

### Rising Stars: The “Fifth Generation” Leadership

Li Keqiang (50), *Party secretary, Liaoning. Born in Anhui, economist;*

Zhang Baoshun (55), *governor, Shanxi. Born in Hebei, economist;*

Li Yuanchao (55), *Party secretary, Jiangsu. Born in Jiangsu, lawyer;*

Yuan Chunqing (53), *deputy Party secretary, Shaanxi. Born in Hunan, doctor;*

Liu Qibao (52), *deputy secretary, Guangxi. Born in Anhui, economist;*

Han Zheng (51), *mayor of Shanghai. Born in Zhejiang.*

# CHINA: THE BALANCE SHEET

## NONGOVERNMENTAL ORGANIZATIONS

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### BACKGROUND

- The past decade **has witnessed an explosion of NGOs working on a broad range of issues the government has been unable or unwilling to address.** Such bottom-up activism was facilitated by the passage of new laws in the late 1990s that created a legal framework for NGOs.
- **By 2005, according to official statistics, there were nearly 280,000 NGOs in China,** excluding those unregistered. However, some outside estimates calculate there are more than 8 million registered and unregistered nongovernmental and quasi-governmental associations in China.
- More than **200 international NGOs have set up offices in China and are most numerous (with more than 50 groups) in the environmental sphere.** The next five top areas of international NGO work are rural development, education, health, HIV/AIDS, and disability.
- In spite of some greater openness toward NGOs, the summer of 2005 saw a **steady tightening of Chinese government regulation on such groups.**

### CURRENT SITUATION

- NGOs, both domestic and international, present a conundrum for the Chinese leadership.
- The Party appears to allow and even encourage organizations carrying out charitable, social welfare, poverty alleviation, and other “non-political” work.

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# NONGOVERNMENTAL ORGANIZATIONS

- However, **organizations that are deemed “political” or seen as critical of the Party still face repression.** It is up to Party officials, often at local levels, to determine which groups are “political” and which are not.
- **The authorities have started to scrutinize activities of both international NGOs that support work in China** and domestic NGOs that receive foreign funding. New regulations expected in 2006 will impose the same supervision and guidance requirements on foreign NGOs as are currently placed on domestic groups.

## IMPLICATIONS

- **NGOs can help fill the space that has opened** as the government has pulled back from social services and the market has increasingly taken over.
- These growing numbers of social entrepreneurs are essential to China’s future not simply because of the services they provide, but also because they are **forming the foundation for a more vibrant civil society.**
- On the other hand, the more independent and well-organized that NGOs are, the greater their perceived threat to the Party.

### NGO Activities

*While environmental NGOs were the vanguard, other major areas of social entrepreneurship have opened up:*

*Health: Health NGOs are one of the largest and fastest growing NGO sectors in China, ranging from small, unregistered self-help groups to larger NGOs carrying out education projects, legal aid, advocacy, or research. Some health NGOs focus on specific groups—women, HIV/AIDS or cancer patients, or children—while others undertake projects to improve rural health care service.*

*Legal Aid: A growing number of legal aid NGOs established within university law schools have paralleled the government creation of legal aid centers in the 1990s. One of the first was Beijing University’s Center for Women’s Law Studies and Legal Services, which since 1995 has provided women legal advice and pro bono legal support. This NGO’s success led other law schools to create or host legal aid organizations for women, children, migrant workers, and pollution victims.*

*Rural Development and Poverty Alleviation: Some NGOs in this sector are religious-based, such as the Amity Foundation, one of China’s largest and most autonomous poverty alleviation NGOs, established by the Jiangsu Christian Council in 1985. This NGO implements drinking water, health, education, microfinance, and afforestation projects in rural areas. Many rural development NGOs are locally based volunteer groups, such as the Snowland Service Group, which builds schools, medical clinics, and water systems in Tibetan communities in southwest Qinghai’s Yushu prefecture, one of China’s poorest places.*

# CHINA: THE BALANCE SHEET

## HUMAN RIGHTS & RELIGIOUS FREEDOM

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### BACKGROUND

- China's record on human rights and religious freedom is rightly open to criticism, both from within China and from the international community. **Amnesty International reports that “tens of thousands of people continued to be detained or imprisoned in violation of their fundamental human rights” in 2005.**
- In December 2005, the United Nations Special Rapporteur on Torture concluded a visit and found that **“the practice of torture, though on the decline – particularly in urban areas– remains widespread in China.”**
- The U.S. Commission on International Religious Freedom found that **the government “continues to engage in systematic and egregious violations of religious freedom”** and that “prominent religious leaders and laypersons alike continue to be confined, tortured, imprisoned and subjected to other forms of ill treatment on account of their religion or belief.”
- **As many as 135 Tibetans, two-thirds of whom are monks or nuns, are reportedly imprisoned on political grounds.** In the Xinjiang region, especially since the late 1990s, Beijing has likewise put down Islamic religious activities linked to separatism, which has had a chilling effect on religious expression.

### CURRENT SITUATION

- The outlook for human rights in China is currently uncertain. Some important progress is evident: **Beijing no longer simply dismisses international norms and concerns, but feels compelled to respond to them.** Permitting the visit of the United Nations Special Rapporteur on Torture in 2005 – albeit after some ten years of negotiation – was a step in the right direction.

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# HUMAN RIGHTS & RELIGIOUS FREEDOM

- **China has ratified the United Nations International Covenant on Economic, Social, and Cultural Rights and signed, but not yet ratified, the United Nations International Covenant on Civil and Political Rights.** In December 2005, despite rejecting the findings of the United Nations Human Rights rapporteur on torture, China “expressed willingness to work with him and the United Nations on future visits.”
- **The U.S. State Department notes that China’s modernization has “improved dramatically the lives of hundreds of millions of Chinese, increased social mobility, and expanded the scope of personal freedom.** This has meant substantially greater freedom of travel, employment opportunities, educational and cultural pursuits, job and housing choices, and access to information.”
- **China has also agreed to discuss human rights as part of the ongoing “senior leaders dialogue” with the United States** and carries out a formal human rights dialogue with the European Union.
- There are an estimated **70 million practicing Christians in China today.** Approximately 8 percent of the Chinese population is Buddhist, and 1.5 percent is Muslim. There are also several hundred thousand Taoists and hundreds of millions of Chinese who engage in traditional folk religions. There are thought to be hundreds of thousands of Falun Gong practitioners across China.
- Notwithstanding, **nearly all outside observers have found that in spite of improvements in some areas, there has been general backsliding in China for human rights and religious freedom under the new Hu-Wen leadership.** The Party continues to crackdown on civil, particularly religious, groups that may generate political loyalties to persons or authorities beyond its control.

*The Freedom House survey for 2005 ranks China at 6.5 on a scale of 1 to 7, with 7 designating the least free countries in the world. Human Rights Watch 2005 concludes that China “remains a highly repressive state.” Amnesty International and the U.S. Congressional-Executive Commission on China effectively echo these findings.*

## IMPLICATIONS

- The human rights situation in China presents a mixed picture. Whether the current backsliding is another example of the tightening and loosening that has traditionally characterized the Party’s approach to human rights and religious freedom or whether it is a sign of a fundamental shift in policy needs to be closely monitored.
- **Pressing Beijing for improvements in its human rights record should be an indispensable part of U.S. China policy.** At the same time, such efforts should be accompanied by informed and realistic expectations.



# CHINA: THE BALANCE SHEET

## MEDIA

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### BACKGROUND

- Some 11,000 newspapers and magazines, more than 500 publishing houses, and more than 600 radio and TV stations have sprung up in China following partial privatization of the media sector. They are increasingly more responsive to the market that now keeps them afloat than to the Party.
- The Central Propaganda Department nevertheless battles to keep a tight grip on the media. According to Reporters Without Borders, in 2004, 17 journalists were arrested, 65 media outlets were censored, and 3 laws repressive of the media were passed. Moreover, according to the same report, **China began 2005 as the world's largest prison for journalists** – with at least 27 journalists in jail.
- The latest crackdown on the media can be traced to the Party's fourth plenum, held in September 2004, where **strengthening ideological control over the media** was a focus.
- It appears that the Hu-Wen leadership team, which initially welcomed media reporting on previously taboo subjects such as official corruption and social unrest, is as willing as its predecessors to **gag the media when the debate goes beyond the officially sanctioned parameters that the Party has set.**

### CURRENT SITUATION

- The Internet represents the leading edge of China's halting approach to freedom of information.
- **In 2005, China had more than 111 million Internet users**, an 18 percent increase over 2004 – the world's second largest Internet market.
- The Party has devoted vast assets to create one of the world's most sophisticated communications monitoring and filtering regimes. The Ministry of Information Industry, Ministry of Public

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# MEDIA

Security, and State Secrets Bureau among them employ an estimated **30,000 Internet police**.

- **The government's Internet monitoring technology is backed up by legal and regulatory policies enforced on Internet service and content providers** such as Yahoo, Microsoft and Google. Through such measures, **the Party seeks to maintain censorship over the Internet; block access to foreign sites**, such as the BBC and Voice of America as well as content related to terms such as "human rights," "Taiwan" or "Tibetan independence" and "Falungong;" and order removal of blog content critical of the Communist Party.
- Chinese authorities defended their Internet controls in February 2006, claiming that they are just following international practice of blocking "harmful" Web sites that promote such things as pornography and terrorism. Observers estimate that there are **49 "cyberdissidents" and 32 journalists currently in detention for posting information on the Internet critical of the Communist Party.**

## IMPLICATIONS

- **The Internet is a double-edged sword for a Party trying to maintain control over the media** – crucial for economic modernization, but providing an estimated 111 million Chinese netizens with unprecedented access to information.
- **In an age of technological advancement, the Party cannot control access to all information.** A new Web browser called Tor is already enabling tens of thousands of Chinese to circumvent Internet police firewalls.

Journalists also are pushing back:

- In December 2005, some 100 journalists from *The Beijing News*, one of China's more progressive newspapers, took the rare move of going on strike to protest the dismissal of the paper's editor and two of his deputies.
- In January 2006, 13 veteran intellectuals and Party officials, including Mao Zedong's former secretary Li Rui and former Central Propaganda chief Zhu Houze, protested against the closure of *Bingdian (Freezing Point)*, forcing a partial climb down by the authorities when the paper was reinstated but with its editors demoted.
- Whether the tougher steps taken toward some media in 2005 is another example of the tightening and loosening that has traditionally characterized the Party's approach to media liberalization or a sign of a fundamental policy shift needs to be closely monitored.
- Observers should also recognize that the **privatization of media now unfolding in China may signal some greater openness in the future.**

### The Media as a Watchdog

*In December 2005, in Dongzhou Village, Guangdong Province, local police opened fire, killing as many as 20 people during a confrontation with villagers protesting construction of a local power plant. Complaints over inadequate compensation for seized farmland, the loss of fishing grounds, and environmental hazards escalated into a violent confrontation involving more than 300 villagers and the police. Initially, local officials denied the shootings and refused comment but were forced to respond after locals alerted the Hong Kong media, via cell phones and the Internet, to report on events. In a highly unusual move, the central authorities not only confirmed the incident but admitted that it was "a mistake" and detained the local official responsible for authorizing the police action.*

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*"History proves that only an autocratic system needs a clamp on the press and wants to blind the masses forever . . . we were all senior revolutionary people inspired by freedom . . . we know that once the freedom of speech is lost, the authorities can only hear one voice."*

—*"Joint Declaration" signed by 13 senior veteran cadres protesting the closure of Bingdian (Freezing Point).*

# CHINA: THE BALANCE SHEET

## RULE OF LAW

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## BACKGROUND

- No one claims that China is today a rule-of-law country. **The harsh criminal justice system is still plagued by torture**, aggressive defense lawyers are likely to end up as defendants themselves, and successful businesses can be expropriated by local governments.
- Nevertheless, most would acknowledge that **China is moving toward a legal system that increasingly seeks to restrain the arbitrary exercise of state and private power** and that provides the promise, if not the guarantee, of reliance on law to assert rights.
- Since 1979, the National People's Congress (NPC) has enacted and updated more than 200 laws, generally consistent with accepted principles of international law.
- **China has also concluded a large number of international agreements**, including 21 international conventions on human rights and World Trade Organization accession agreements. China's courts are answerable to the NPC—not an independent branch of government. Judges are appointed and remunerated by local-level PC's, exacerbating local protectionism and political influence.
- **China's 3,000 basic courts and 200,000 judges cannot yet consistently protect the rights and interests of citizens** through an independent authority to enforce government and private compliance with the law.
- While courts hear 6 million cases per year, government agencies, including the courts themselves, are flooded with nearly twice as many petitions to resolve a range of grievances—**30 percent of which are about the legal system and the handling of specific cases.**

For further information, see Chapter 3:

“China's Domestic Transformation: Democratization or Disorder?”

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# RULE OF LAW

## CURRENT SITUATION

- The landmark 1989 Administrative Litigation Law, fortified by the 1994 State Compensation Law, grants citizens **the unprecedented right to sue the government over “concrete” government actions that violate their rights and interests.**
- The 1996 Administrative Penalties Law (APL) and 2004 Administrative Licensing Law impose procedural constraints on government action itself. **The APL is the first law to provide regulated persons the right to defend their case and the right to a public hearing,** thus introducing the concept of procedural due process.
- The NPC, criticized for being a “rubber stamp,” is being made more professional, transparent, and responsive. **Many people’s deputies now reach out to their putative constituents for feedback,** as some seek to more effectively carry out their constitutional duties.
- **Only 40 percent of judges hold a university degree.** The quality of personnel is uneven, and low salaries enhance corruption’s allure.
- Starting with fewer than 2,000 lawyers in 1979, however, **China now has around 120,000 certified lawyers** and more than 300 law schools.
- More than 3,000 government-sponsored legal aid clinics claim to have aided some 1.6 million clients. **In 2005, for the first time, the Ministry of Justice allocated \$6.2 million for legal aid in impoverished areas,** while local governments earmarked another \$32 million.

### Rule of Law and the Environment

*Citizens’ rights to influence environmental laws improved with passage of the 2003 Environmental Impact Assessment (EIA) Law, which requires the evaluation of infrastructure plans. Notably, EIA reports must now be published and available for public comment.*

*Government agencies are increasingly the target of court cases: In preparation for the 2008 Olympics, residents in one Beijing suburb took the Environmental Protection Bureau to court over the approval of a construction project. A landmark settlement was reached in January 2005 in Inner Mongolia, when two paper mills and a water-treatment bureau agreed to pay \$285,000 to the Baotou City Water Supply Company. In 2004, polluted wastewater from the mills forced the company to stop using water, leading to economic losses.*

*Beginning in the late 1990s, private Chinese law firms began specializing in environmental cases, many of which have been class-action water pollution cases. They have been winning cases by moving them to courtrooms outside the influence of the local government where the events took place. The environmental NGO, Center for Legal Assistance for Pollution Victims, has also been established.*

*By the end of 2005, provincial governments and central ministries had held 74 rulemaking hearings, and 827 expert seminars and released 500 draft rules for public comment. Many local governments are publishing draft rules and regulations for public input. Most governments above the county level now regularly post a great deal of information on more than 10,000 Web sites and hold periodic press conferences on their activities.*

## IMPLICATIONS

- Establishing the rule of law in authoritarian China presents a paradox, similar to the creation of a “socialist market economy.” **Despite its refusal to relinquish ultimate power over the legal system, the Party does not recognize how the greater rule of law can benefit its own legitimacy and “governing capacity”** as well as to the Chinese economy and society, in moving toward greater rule of law.

# CHINA: THE BALANCE SHEET

## TRADE IMBALANCE

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### BACKGROUND

- China has run a bilateral trade surplus with the United States since the late 1980s. **These surpluses increased steadily in the 1990s, and China became the largest single source of the U.S. global deficit in 2003.** In 2005, the U.S. bilateral trade deficit with China exceeded \$200 billion – more than one-fourth of its total imbalance. U.S. imports from China are now almost six times as large as U.S. exports to China, so future U.S. exports would have to grow almost six times as fast as imports just to keep the bilateral imbalance from increasing further.
- Bilateral imbalances should not be a focus of national policies because of the multilateral nature of international trade. **The China-U.S. bilateral position, however, reflects both countries' large worldwide imbalances.** The United States is by far the world's largest deficit and debtor country, and its global current account deficit hit an annual rate of \$900 billion in the final quarter of 2005 (7 percent of GDP). China's global current account surplus, after averaging only 1.6 percent of its GDP during 1993–2002, soared to about \$150 billion (almost 7 percent of GDP) in 2005. **These global disequilibria are a major source of concern: they could lead at virtually any time to a large and disorderly fall in the exchange rate of the dollar,** pushing up U.S. inflation and interest rates with very negative effects on the U.S. and world economies, and/or to a sharp outbreak of trade protectionism in the Congress.

For further information, see Chapter 4:

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# TRADE IMBALANCE

## CURRENT SITUATION

### Why is China's Surplus so Large?

- **Chinese officials frequently assert that the imbalance would be much smaller if the United States would approve more high technology exports to China.** However, the Department of Commerce rejected only \$12.5 million in potential sales in FY2005 and returned applications, for incompleteness and other reasons, of only \$550 million more. Approval of all these licenses would have cut the bilateral deficit by only 0.3 percent.
- A common explanation, especially in the United States, is that **China blocks access to its market for U.S. (and other foreign) products.** But the effective tariff ratio in China, import tariff revenue collected as a share of the value of imports, was only 2.2 percent in 2004. **Even China's average level of announced tariffs, at 10.4 percent in 2004, is among the lowest of any developing country.** China eliminated all import licensing requirements and virtually all import quotas by 2005.
- More broadly, China's ratio of imports to GDP has soared from 5 percent in 1978 to 30 percent in 2005. By that measure, **China is now twice as open to trade as the United States and three times as open as Japan.** China has in fact been the most rapidly growing market for U.S. exports for the last 15 years: during 2000–2005, for example, U.S. exports to China grew by 160 percent while its exports to the rest of the world rose by only 10 percent. China needs to further open its markets for a number of products, but its import regime does not explain much of the imbalance.
- Another explanation for the imbalance is that **the United States (and other high-income countries) cannot compete with China's low-wage labor,** which earns only about one-thirtieth that of its American counterparts. However, Chinese productivity is also only about one-thirtieth that of the United States. Moreover, wages account for only 5 percent of the total cost of producing semiconductors and no more than 20 percent of the costs for apparel. More broadly, many developing countries have lower wages than China but are not large exporters, and the United States, with wages among the highest of any country, is the world's second largest exporter. **"Low wages" cannot explain the large trade imbalance.**
- **The most persuasive explanation of the growing bilateral deficit is the increasing role of China as the final assembler in Asia-wide production networks.** Over the past two decades, the production process for a growing range of manufactured goods has become increasingly disaggregated on a geographical basis. Each country serves as the location for the portion of the process in which it has the strongest comparative advantage. Higher-income, more technologically advanced countries like the United States have come to specialize in producing high value-added parts and components. **China, with its large pool of workers available for unskilled labor-intensive operations, has increasingly become the location of choice for the final assembly of a broad range of goods, especially electronic and information technology products.**

## TRADE IMBALANCE

- **Goods that are assembled from imported parts and components now account for about 55 percent of China's total exports and about 65 percent of the goods China exports to the United States.** When these goods are exported from China to the United States, their entire value is counted by U.S. Customs as imports from China. On average, however, about two-thirds of the value of these so-called processed exports in fact originate outside China, mostly in other Asian countries.
- **China's rise as the point of final assembly of a broad range of manufactured goods is reflected in the sharp decline over the past two decades in the share of the U.S. bilateral trade imbalance that originates in other Asian countries** (especially Hong Kong, Taiwan, Korea, and Japan). As these countries have moved manufacturing capacity to China – and, in the case of Japanese autos, to the United States – the share of the U.S. trade deficit that they account for has fallen by two-thirds, from more than 50 percent in 1985 to only 16 percent in 2004, while China's share has risen from nothing to about one quarter. **The United States must understand that it will continue to run a sizable bilateral deficit with China, as recorded in the conventional statistics, largely because of the growing internationalization of production with China as the final assembly point for many products.**
- This structural source of China's burgeoning trade surpluses, especially its global imbalance, has been intensified in recent years by the growing undervaluation of China's currency, the renminbi (RMB). This issue has become a central point of debate between the two countries.
- **It is clear that the average exchange rate of the RMB is now undervalued by 20 percent to 40 percent** (and that its bilateral rate against the dollar is undervalued by even more). **China has intervened massively in the foreign exchange markets for several years to keep the RMB from rising in value, resisting market pressures for a much stronger currency, by selling RMB for dollars.** As a result, its foreign exchange reserves are rising rapidly toward \$1 trillion, the largest in the world. By maintaining its dollar peg as the dollar declined against most other currencies over the past few years, the RMB has in fact recorded a cumulative depreciation that has made China even more competitive. Its minor currency reform of July 2005 had no appreciable impact on the situation. **A revaluation of the RMB by 20 percent, if accompanied by an equal appreciation of the other major Asian currencies, should reduce the U.S. global current account deficit by \$60 billion to \$80 billion per year.**

# CHINA: THE BALANCE SHEET

## EXCHANGE RATE

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

## BACKGROUND

- **The Chinese renminbi (RMB) is undervalued by 20 percent to 40 percent on average and by even more against the dollar.** This distortion adds substantially to the competitiveness of Chinese products in international trade.
- Other Asian countries are reluctant to let their exchange rates rise against China's because of the adverse effects on their own competitiveness. **RMB undervaluation thus promotes undervaluation of other important currencies against the dollar.** A substantial RMB revaluation is essential to moderate the huge global trade imbalances centered on the U.S. current account deficit, which reached an annual rate of \$900 billion in the last quarter of 2005.
- **Most countries let their currencies fluctuate largely in response to market forces. China, however, has pegged the RMB to the dollar at a virtually fixed exchange rate since 1995.** It has maintained that peg by buying \$15 billion–\$20 billion per month in the exchange markets to resist market pressures for a stronger RMB. Those pressures emanate from China's large and rapidly growing trade surpluses, substantial inflows of foreign direct investment and speculative capital inflows betting on eventual RMB revaluation. **By continuing to peg to the dollar since 2002, during a period when the dollar was declining against most other currencies, the RMB has actually fallen in value against most currencies and enabled China to become even more competitive.**

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# EXCHANGE RATE

## CURRENT SITUATION

- Two issues arise: the level of the exchange rate of RMB and the currency regime implemented by China. The U.S. government, G-7, and IMF have tended to focus on the regime, arguing that China should let its currency fluctuate in response to market forces. **The Chinese, while agreeing that a floating currency is desirable in the long run, have responded that such a change now could produce a large movement of money out of the country that would further weaken China's banking system and jeopardize its economy.** This position, however, confuses two issues -- floating the currency and the relaxation of capital controls. It is quite feasible to do the former but not the latter.
- **The immediate need is for a substantial rise in the value of the RMB rather than a relaxation of capital controls.** A rise in the rate can be achieved by one or more revaluations or by allowing the currency to float upward. China has taken several small steps in that direction, revaluing by 2.1 percent in July 2005 and letting the currency creep upward a bit further in early 2006. It has also announced that **the RMB would henceforth be managed against a basket of currencies rather than solely against the dollar.** Through March 2006, however, China continued to intervene massively to keep the RMB from rising substantially.
- China resists currency appreciation for several reasons. **It values the "stability" offered by its fixed peg to the dollar** (although the wide fluctuations of the dollar against most other currencies instead produce a very unstable RMB). It hesitates to inject a new uncertainty into its economic outlook. **It worries that any reduction in its trade competitiveness would add to its transitional unemployment.** It also apparently doubts that the United States or the relevant international organizations (IMF, WTO) will force it to move, essentially viewing currency undervaluation as an off-budget job and export subsidy that avoids effective international reaction.

## IMPLICATIONS

- **China will have to phase in a faster expansion of domestic consumption and government spending to offset the dampening of its economic growth from the decline in its trade surplus that is the intended result of currency appreciation.** Fortunately, sharp increases in government spending on health care, education, and pensions are needed in any event because such benefits, which were previously provided by state-owned enterprises, are now grossly inadequate and social unrest has resulted from their elimination.
- An early and sizable revaluation of the RMB, however, is essential for three reasons. **It would moderate China's own surplus against the United States and the rest of the world. It would enable other Asian surplus countries to let their currencies rise against the RMB** (and hence against the dollar) and thereby participate constructively in the global adjustment process. **It would head off protectionist pressures against China in both the United States and Europe,** pressures likely to erupt in the near future in the absence of substantial revaluation.

# CHINA: THE BALANCE SHEET

## INTELLECTUAL PROPERTY PROTECTION

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### BACKGROUND

- China agreed when it entered the WTO to adhere to international norms to protect and enforce minimum standards of protection for copyrights, trademarks, and patents. **Although China has established an intellectual property rights (IPR) legal regime that largely meets WTO standards, enforcement is inadequate.** Copyright piracy of software and recorded entertainment products, trademark counterfeiting, patent infringement, and unauthorized use of trade secrets remain widespread.
- **China's failure to protect intellectual property is a major source of friction in the U.S.-China economic relationship.** The economic burden of piracy and counterfeiting falls heavily on U.S. firms, which clearly have a comparative advantage in research-based pharmaceuticals, software, movies, music, and video games.

### CURRENT SITUATION

Some developments bode well for increased IPR protection in China in the long run:

- **The number of patents filed and trademarks registered in China continues to grow:** In 2005, China's patent applications with the World Intellectual Property Organization (WIPO) soared 44 percent—making China, for the first time, one of the top 10 patent filing countries.
- The long-term rise in trademark registrations also continued: In 1983, fewer than 20,000 trademarks were registered with China's State Administration of Industry and Commerce (SAIC), but by 2004, there were 588,000 applications, and **by mid-2005, the cumulative number of registered trademarks reached 2.37 million.**

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# INTELLECTUAL PROPERTY PROTECTION

- **More than 80 percent of registered trademarks, and most trademark and patent investigations and litigation, involve domestic firms.** In the first half of 2005, for example, SAIC investigated more than 18,000 trademark infringement cases, of which only about one-eighth involved trademarks registered by foreign parties. Similarly, more than 90 percent of all the cases in China's IPR courts involve Chinese parties suing other Chinese companies. **This increasing domestic desire for IPR protection suggests China's IPR regime will improve in the years ahead.**

## IMPLICATIONS

- **The United States should keep pressing China to fulfill its WTO IPR commitments.** Many IPR violations arise or persist with collusion from provincial and local leaders, who generally value the jobs and tax revenues that factories producing pirated intellectual property provide. **All too frequently these IPR violations appear to be concealed from the central authorities, who are more committed to enforcement of IPR laws.** Thus, at a minimum, high-level dialogue on IPR violations can help keep the central government well informed.
- More important, **the United States has an interest in ensuring that pending and potential rules, regulatory standards, and laws are consistent with or stronger than China's WTO commitments.** For example, the United States should continue to encourage China to sign the Government Procurement Agreement and to accede to certain Internet protocols of the WIPO. In the realm of pending laws and regulations, the United States should seek modifications of certain provisions of a proposed anti-monopoly law, which has been in the drafting process since 1994, and a proposed regulation for national standards involving patents; otherwise, these might be used to undermine foreign companies' intellectual property rights - for example, by forcing them to license their technology at a government-determined price.
- More generally, **the United States should seek to persuade China to adopt market-friendly regulatory standards that provide equal market access for all firms.**

### Should the United States Bring a WTO Case against China on IPR?

*Some experts believe the United States should file a formal case with the WTO Dispute Settlement Body, charging that China has failed to adequately enforce the WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS).*

*Such a case would be hard to win, however. First, the TRIPS agreement neither defines what constitutes effective enforcement nor requires a member state to devote more resources to IPR protection than to other areas of law enforcement. Second, the U.S. Trade Representative's ability to file a case based on inadequate enforcement in general is severely handicapped by U.S. companies' unwillingness to provide concrete evidence of intellectual property violations by Chinese firms. Meanwhile, losing such a case would enable China to claim endorsement of the status quo.*

# CHINA: THE BALANCE SHEET

## TECHNOLOGY

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### BACKGROUND

- A decade or so ago, China was primarily a supplier of obviously low-tech goods, such as apparel, toys, footwear, and sporting goods.
- Today, China is the world's largest producer, and the largest U.S. supplier, of personal computers and other seemingly much more sophisticated products.
- **Some worry that China is well on its way to becoming an advanced technology superstate,** able to compete globally not just at the labor-intensive end of the product spectrum, but also at the capital- and technology-intensive end where the United States historically has been a leader.

### CURRENT SITUATION

- **China awards four times more undergraduate engineering degrees than does the United States.** Many, however, are civil and electrical engineers, for which there is an enormous demand because of massive public infrastructure investment and a construction boom. China, for example, currently has about 70 to 80 major subway lines under construction, while the United States has none.
- While China's numbers of engineers are impressive, their average quality is less so. The McKinsey Global Institute estimates that only **one-tenth of China's engineering and IT graduates are capable of competing in the global outsourcing environment,** and that only 160,000 of China's engineers are qualified for employment in international or high-quality domestic firms—roughly the same number available in the United Kingdom.

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# TECHNOLOGY

- Although **China's R&D expenditures are rising rapidly, they are only about one-tenth the U.S. level.** Indeed, the United States alone accounts for about 40 percent of global R&D expenditure and employs almost one-third of all science and engineering researchers worldwide.
- The U.S. Bureau of the Census reports that **the United States imported \$45.7 billion in "advanced technology products" from China in 2004, a more than six-fold increase since 1998.** But the most important of these products are notebook computers, display units, and CD and DVD players, which are imported in such huge quantities and at such a low unit cost that they are probably seen better as mass market commodities than as advanced technology products.

## IMPLICATIONS

- Evaluating the extent to which China is becoming a technological superpower involves far more than simply identifying China as the location in which seemingly more sophisticated products are assembled. Yes, more advanced technologies and management techniques are diffusing into the local economy, allowing indigenous firms to move up the technology ladder and raising the local share of value added. But **this is a gradual process, not a leapfrogging that will make China a technological superpower overnight.**
- Remember Japan? Some 20 years ago, commentators argued that Japanese firms' competitive edge was so great and their export growth so unstoppable that Japan was likely to displace virtually all U.S. manufacturing. Yet, **U.S. firms today account for 24 percent of global manufacturing output, the same as in 1994. Japan's share has fallen from 24 percent to 21 percent over the same period, the largest decline of any advanced industrial country.**

### Made by China vs. Made in China

- *Almost 90 percent of China's exports of electronic and information technology products are made by foreign firms. Typically these firms are wholly foreign-owned, which makes them much less inclined than joint ventures to share technology, and they are located in enclave-like settings where interaction with domestic firms appears somewhat limited. For example, they import parts and components rather than sourcing from domestic firms. China's contribution is limited to providing the labor to assemble the components.*
- *Eventually, indigenous firms will develop the capability to produce a growing share of the high value-added parts and components that are now imported and to organize large-scale production of information technology or other more advanced products. But this will take considerable time. Chinese firms have not developed strong domestic technology supply networks; their collaboration with universities is extremely limited; and their absorption and diffusion of imported technology is uneven.*
- *Moreover, China is at the early stages of developing private property rights, respect for intellectual property, and the venture capital financing that are important long-run contributors to converting scientific and technical innovations into successful commercial ventures.*

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*Does it make more sense for products imported in huge volumes and at relatively low cost per unit to be regarded as "leading edge technology" or as mass-market commodities?*

# CHINA: THE BALANCE SHEET

## FOREIGN POLICY

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### BACKGROUND

- **China often characterizes its foreign policy and national security goals in terms of a series of principles and slogans.**
- Since the 1980s under Deng Xiaoping, Beijing has said it pursues an “independent foreign policy of peace” under which China’s “fundamental” foreign policy goals are:
  - **“To preserve China’s independence, sovereignty and territorial integrity,”** and
  - **“To create a favorable international environment for China’s reform and opening up and modernization.”**
- China’s concern over its “territorial integrity” is most associated with (re)assumption of sovereign control over Taiwan and continued control over the restive western autonomous regions of Xinjiang and Tibet.
- As communism declined as a credible ideology, **the measure of the Chinese Communist Party’s fitness to lead – and arguably its survival – became based on its ability to enhance national prosperity, restore China’s prestige and stature as a great power, and unify the nation.**

### CURRENT SITUATION

- **China has placed particular emphasis on the development of “good-neighborly” relations and “partnership” with border countries in order to prevent external threats from exacerbating internal frictions.** China has emphasized non-military aspects of its comprehensive national power, adopting a three-pronged approach of:
  - Setting aside areas of disagreement with neighboring states;
  - Focusing on confidence-building measures to promote ties; and
  - Engaging in economic integration and multilateral cooperation to address shared concerns.

For further information, see Chapter 5:  
“China’s Foreign & Security Policy: Partner or Rival?”

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# FOREIGN POLICY

- **China has sought to isolate Taiwan in the international community**, including withdrawing official recognition from the dwindling number of African, Latin American, and Oceanic nations that have official diplomatic relations with the “Republic of China on Taiwan.”
- China’s urgent need to acquire natural resources for its economic development, including but not limited to energy (oil and natural gas), has led **Beijing to develop relationships with an increasing array of nations.**

*China has proclaimed its interest in a “peaceful international environment” to enable Beijing to focus its energies inward on its enormous internal challenges.*

## IMPLICATIONS

- **China’s essentially defensive posture and keen desire for a peaceful international environment to allow focus on its domestic challenges provide hope for cooperation with the United States** (and others) to sustain regional stability and common development.
- **Questions remain about future Chinese foreign policy, however, particularly as China becomes stronger**; for instance, how will overlapping territorial claims in the South China Sea, East China Sea, and along its western border (with India) be resolved? How will China apply its growing political and economic power should its domestic situation falter?
- **China’s “energy diplomacy” has led to close relationships with unsavory regimes**, which has raised questions about China’s role as a responsible international actor.

Term	Definition	Implications
“Five Principles of Peaceful Coexistence”	<ul style="list-style-type: none"> <li>● Mutual respect for sovereignty and territorial integrity;</li> <li>● Mutual non-aggression;</li> <li>● Non-interference;</li> <li>● Equality and mutual benefit;</li> <li>● Peaceful coexistence</li> </ul>	<ul style="list-style-type: none"> <li>● Good-neighborly relations—preventing external instabilities from “spilling over” to fuel internal frictions;</li> <li>● Non-interference in internal affairs, most notably Taiwan, Tibet, Xinjiang.</li> </ul>
“New Security Concept”	<p>Unveiled in 1997 to reflect China’s aspiration for a new post-Cold War international security order:</p> <ul style="list-style-type: none"> <li>● Adherence to the Five Principles of Peaceful Coexistence;</li> <li>● Emphasis on mutually beneficial economic cooperation among states;</li> <li>● Pursuit of confidence-building measures amongst states;</li> <li>● Establishment of bilateral “strategic partnerships” that are not directed at any third country</li> </ul>	<ul style="list-style-type: none"> <li>● Marks new proactive Chinese approach to international affairs;</li> <li>● Offers alternative vision of international order, particularly in relation to the U.S. alliance based security structure in East Asia.</li> </ul>
“Peaceful Rise”/ “Peaceful Development”	Campaign to reassure the international community, and particularly neighboring countries, of China’s benign future and that China’s rise will not be a zero-sum game.	
“Period of Strategic Opportunity”	Conceived in 2002, the next twenty years will be a period during which China’s relations with its periphery and with major powers such as the United States are expected to remain essentially stable to allow the PRC to focus its attention on “building a well-off society” at home.	

# CHINA: THE BALANCE SHEET

## VIEW OF THE UNITED STATES

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### BACKGROUND

- **China's people remain enamored of U.S.** wealth, power, freedoms, advanced technology, and popular culture, and feel positively about Americans as individuals.
- Given Beijing's paramount near- and mid-term priority on attending to its internal challenges and maintaining a peaceful international environment, China's leaders have assiduously sought to **maintain a relationship with Washington that is correct** and cordial, if not conspicuously warm.
- At the same time, they are suspicious of and attuned to perceived hypocrisy in U.S. foreign policy.
  - **Elite Chinese harbor lingering grievances over past indignities and perceived victimization** at the hands of the United States, including the EP-3 spy plane incident in 2001, the accidental U.S. bombing of China's embassy in Belgrade in 1999, U.S. congressional opposition in the mid-1990s to China's application to host the Olympic Games, and continuing U.S. arms sales and defense support for Taiwan.
  - The long-term implications for the relationship of these grievances are uncertain but may be subject to rising populist nationalism in China.
- China also often reveals its discomfort with U.S. global predominance, fueled by a belief among Chinese officials and elite that the United States will seek to slow or block China's emergence as a great power by seeking to:
  - **Split China through policies** of humanitarian intervention, preemption, alliances, missile defense or permanently **separating Taiwan** from the mainland, de facto if not de jure;

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## VIEW OF THE UNITED STATES

- Westernize China by propagating “universal values” of democracy and human rights in order to induce change in China’s political system and bring about the downfall of the Chinese Communist Party;
- **Deprive China of an adequate supply of energy** for its development;
- **Draw China down the same path it led the Soviet Union**, leading to the collapse and dissolution of the Chinese state. China often acts consciously to avoid mirroring Soviet missteps, whether by abjuring the notion of engaging in an arms race with the United States, carefully affirming its intent not to place itself in ideological opposition to the United States, or focusing on economic development before addressing dramatic political reform;
- Expand U.S. influence along China’s periphery, **leading to the development of anti-China blocs** that may seek to contain Chinese power or infiltrate and destabilize China’s minority regions.

*At a fundamental level, many Chinese officials and elite are convinced that the United States through various methods will seek to slow or block China’s emergence as a great power.*

*Chinese leaders judge virtually all U.S. policies based on their implications for the Taiwan issue, for continued economic development in China, and ultimately for regime survival.*

## CURRENT SITUATION

- China and the United States have **expanded avenues of cooperation** through:
  - The **initiation of a semiannual U.S.-China vice-ministerial Senior Dialogue on strategic issues**, which aims to facilitate candid communication, build understanding, prevent miscalculation, and exchange perspectives at a senior level.
  - Growing government, military, and people-to-people exchanges in the fields of counterterrorism, nonproliferation, UN reform, health, energy, environmental protection, and culture.
  - **Multilateral forums** such as the ASEAN (Association of Southeast Asian Nations) Regional Forum and APEC (the Asia Pacific Economic Cooperation forum).
  - **Coordinating the organization and conduct of Six Party** talks to eliminate North Korea’s nuclear weapons program.

## IMPLICATIONS

- China recognizes the reality of a U.S.-dominated world for the foreseeable future and will likely accommodate where its vital national interests are not directly at stake.
- **Beijing’s pronouncement in 2002 of a two-decade “period of strategic opportunity”** for China was related to its preoccupation with domestic development needs and the U.S. preoccupation with the “War on Terror.”
- Nonetheless, China’s leaders remain worried that once the United States is no longer preoccupied with terrorism, **Washington will return its attention to the “China threat.”**
  - China’s strategists remain focused on the United States as its likely foremost strategic rival in the future.

# CHINA: THE BALANCE SHEET

## U.S. ROLE IN EAST ASIA

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- Chinese leaders **consistently deny an ambition to evict or supplant the United States** in East Asia to become the dominant regional hegemon.
- Nonetheless, suspicions about China's long-term intentions persist, given that China expresses tolerance, at best, of the U.S. security structure in East Asia and to the basing of U.S. military forces in Japan, South Korea, and more recently, Central Asia;
  - China refers to **U.S. efforts to strengthen its military alliances in Asia as one of the “factors of instability”** in the region and as Cold War “relics”;
  - Beijing has promoted a **“New Security Concept” that opposes “military alliances”** in principle while touting confidence-building measures and informal “strategic partnerships” as alternatives to the U.S. alliance structure;
  - China has **supported the development of multilateral vehicles** to promote regional identity that **do not involve the United States**, such as the East Asia Summit, the Shanghai Cooperation Organization (with Central Asia and Russia), and the ASEAN + 3 (China, Japan, Korea) forum;
- Policymakers in Beijing believe that the **United States is using its alliances and regional force presence to support Taiwan's continued separation** from the mainland and to contain China's development more broadly.

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# U.S. ROLE IN EAST ASIA

## CURRENT SITUATION

- China has downplayed its concerns over U.S regional presence in recent years due for these reasons:
  - A desire for stable relations with the United States;
  - Clear support from the rest of East Asia for continuation of the **U.S.-centered regional security structure**;
  - Recognition of the **benefits of U.S. presence** (excepting the Taiwan issue) for maintaining regional stability to enable China to focus on its **critical internal challenges**.

*The ultimate test of China's intentions toward the United States in East Asia will be whether China decides to actively support U.S. involvement in regional affairs. Likewise, the United States will need to consider how to integrate Beijing more fully into an alliance-centered regional security structure that currently excludes China.*

## IMPLICATIONS

- **China will not challenge the United States** directly in East Asia in the near term.
- Nonetheless, China's interest in promoting regional vehicles that exclude the United States lead some analysts to suspect that China, having failed to convince the region of the benefits of its new security concept over the traditional U.S.-centered security structure, has decided to push ahead with its vision in a longer-range attempt to dilute, if not undermine, U.S. regional influence.
- Meanwhile, the region will likely **continue to support a U.S. presence** to serve at least as a tacit counterbalance, or hedge, against the uncertain trajectory of Chinese power, but **will not support a security structure that seeks to pursue a hostile anti-China containment strategy** or that excludes Chinese involvement over time.
- To assist the region in its future strategic calculations, the **United States will need to consider how to integrate Beijing** more fully into the alliance-centered regional security structure – from which China is currently excluded and of which Beijing views itself as the primary target.

# CHINA: THE BALANCE SHEET

## GLOBAL STRATEGIC COMPETITION

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- **China rejects any suggestion of global strategic competition with the United States.**
- Nonetheless, **China has become notably more proactive in its economic and diplomatic outreach.** This has been fueled by:
  - China's economic need to acquire resources, secure investments, and engage markets to continue its economic growth, safeguard domestic stability, and develop its comprehensive national power.
  - China's longer-term political goals to achieve a "multipolar world," in which several pillars of global power, including China, would balance U.S. global influence.
  - China's desire to reassure the international community about its own peaceful intentions in order to hamstring any incentive or attempt to bandwagon against growing Chinese power.

### CURRENT SITUATION

- **U.S. observers have detected a degree of strategic opportunism in China's foreign relations in recent years relative to the United States.** (see box.)
- **China still refers to itself as the "world's largest developing country"** and has paid increasing attention to relations with the developing world as a critical component of its foreign policy.
  - China's promotion of equality and democracy in international affairs and opposition to external intervention in internal affairs appeals to many developing nations.
  - Natural resources necessary for China's development, particularly energy (oil and natural gas), are often found in the developing world.

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# GLOBAL STRATEGIC COMPETITION

- **Nonetheless, Beijing's record of cooperation with developing countries in international institutions and forums is spotty;** Chinese self-interest will often win out over notions of "South-South" solidarity.

## IMPLICATIONS

- China's proactive global outreach in recent years is natural for a growing nation of China's size, stature, economic needs, and desire to demonstrate its peaceful intent.
- **China has little interest in engaging in direct global competition with a superpower,** given its urgent need to focus on its critical domestic challenges.
- **Nonetheless, Beijing's global outreach does appear consistent with longer-term political goals to promote a multipolar world and to protect itself against the preeminent power of the United States,** while placing itself in a position to potentially balance against, if not compete strategically with, the United States once China achieves greater strength.

*Examples of China's strategic opportunism in relation to the United States:*

- *In May 2005, Beijing hosted Uzbek president Islam Karimov two weeks after the United States condemned him for violently suppressing unrest in the Uzbek city of Andijan. In July 2005, the Shanghai Cooperation Organization issued a statement calling on the United States to set a timetable for withdrawing its military presence from Central Asia.*
- *In 2003, Beijing took advantage of a period of tension between the United States and the Philippines to reach agreements with the Philippine government on closer political, military-to-military, and intelligence ties.*
- *China has leveraged growing trade relations with Latin American countries, and the desire of many governments to demonstrate political independence from the United States, to enhance its political ties with the region, including Venezuela, Brazil, Bolivia, and Argentina.*
- *In the wake of tensions between the United States and Europe during the first term of the George W. Bush administration, China appeared to leverage its growing economic, political, and societal relationships with the European Union to exploit transatlantic differences.*
- *U.S. decisions to sanction and/or isolate regimes in Cuba, Venezuela, Sudan, Burma, Iran, Angola, and elsewhere have provided an economic opportunity for Chinese investors, traders, and energy companies to fill the gap and for Beijing to develop political relationships with these governments.*
- *Despite historical mistrust, China's relationship with Russia in recent years has developed markedly as each side has found common cause in protecting itself against U.S. intervention in its internal affairs and in its neighborhood.*
- *In Southeast Asia, U.S. preoccupation with the war on terrorism and impatience with the "ASEAN way" of confidence building and consensus provided China with a strategic opportunity to enhance its position in the region through promotion of multilateral vehicles such as the ASEAN + 3 forum that exclude the United States.*

# CHINA: THE BALANCE SHEET

## TAIWAN

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- **Beijing views the Taiwan issue as an internal matter left over from the Chinese civil war**, when Chiang Kai-Shek's Republic of China government retreated to Taiwan and subsequently fell under the alliance protection of the United States.
- The Taiwan issue is linked to the legitimacy of Chinese Communist Party rule, with **the eventual return of Taiwan to the “motherland” deemed essential to China's self-identity and honor**.
- **China's official policy on Taiwan requires that Taipei accept the “One China” principle** as a precondition for reopening cross-Straits talks and “peaceful reunification” under the “one country, two systems” formula.
- **Taiwan president Chen Shui-bian calls for dialogue without preconditions**, favors discussion of the meaning of “One China,” and insists that the 23 million people in Taiwan determine the island's future.

China's tactics toward Taiwan are two-fold:

- Cultivate closer economic, social, and cultural ties to win over the hearts and minds of Taiwan's people.
- **Increase, upgrade, and modernize its military forces deployed opposite Taiwan:** Beijing claims this is meant to deter independence; others fear that China seeks to acquire the capability to coerce or take Taiwan by force sometime in the future.
  - China's planning for a Taiwan scenario takes into account the possible intervention of the United States.

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# TAIWAN

- China views U.S. involvement with Taiwan, particularly its arms sales and defense ties with the island, as an encouragement to Taiwan's independence forces and a fundamental obstacle to unification.
  - The United States maintains its commitment to Taiwan's security under the Taiwan Relations Act (TRA).
  - **While the United States remains agnostic on the ultimate outcome of the dispute, it urges that any resolution be peaceful and noncoercive, and it opposes unilateral actions by either side to change the status quo.**

## CURRENT SITUATION

- In March 2005 Beijing passed the "Anti-Secession Law," codifying both China's peaceful unification policy and its intention to employ "nonpeaceful means and other necessary measures" to prevent permanent separation.
- In line with its "United Front" strategy of extending benefits to those who are viewed as (relative) allies while avoiding those with whom it disagrees, Beijing has reached out to the Kuomintang/People's First Party opposition, while refusing to deal with the elected Democratic Progressive Party government.
- China's military development and political divisions in Taiwan constraining Taiwan's defense modernization are shifting the military balance in Beijing's favor.
- **Maintaining the status quo remains the Taiwan population's overall preference.**
- Chen's threat to abolish the National Unification Council and National Unification Guidelines in February 2006, contrary to several public vows, has raised concerns in China that **Chen may promote initiatives to distance Taiwan further from the mainland as his term expires in 2008.**

## IMPLICATIONS

- A change in the political landscape in Taiwan favoring independence, a perception that the United States is backing this position, or a **domestic regime legitimacy crisis could lead to a heightened sense of urgency in China that tougher action, even military force, is necessary to prevent Taiwan's separation from the mainland.**
- **The United States will need to continue to exercise a policy of "dual deterrence" across the Taiwan Strait**—encouraging decision makers in both Beijing and Taipei to remain patient, flexible, and constructive and to avoid provocative actions that work against an eventual peaceful resolution of the impasse.

### Facts

- *China-Taiwan trade: \$91.2 billion (2005)*
- *China is Taiwan's leading trade partner*
- *Taiwanese investment on the mainland: \$75 billion—\$100 billion since 1978.*
- *Taiwanese living on the mainland: 1.5 million*
- *Cross-strait intermarriages: 250,000 (since 1992)*
- *China's military build-up across the strait: more than 700 mobile short-range ballistic missiles (augmented by about 100 missiles each year); medium-range ballistic missiles; new long-range land-attack cruise missiles; and other advanced air and naval capabilities.*

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*Rather than compel near-term unification, Beijing appears to be focusing on deterring independence while postponing the task of reunification to the indefinite future.*

# CHINA: THE BALANCE SHEET

## INTERNATIONAL SYSTEM

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- **China has traditionally been suspicious of multilateral structures that could potentially constrain Beijing's sovereignty and independent action.**
- **However, since the late 1990s, China has recognized the political utility of multilateralism and internationalism:**
  - As a means to reassure others about the benign nature of China's rise and commitment to serving as a responsible international actor;
  - As China has become reassured of its ability to safeguard its sovereign interests in multilateral environments;
  - As China has come to appreciate the international system's benefits in addressing transnational challenges such as piracy, drug trafficking, terrorism, and infectious disease;
  - As China has recognized the value of being at the table to shape the rules rather than having the rules imposed upon it.
- **Beijing has affirmed the preeminent authority of international treaties and the United Nations as ultimate arbiters of international law and legitimacy for international actions:**
  - To equalize the process, if not conduct, of international relations;
  - To constrain the ability of major powers to impose themselves on others (including itself);
  - To safeguard its interests within the UN system, given China's veto power in the UN Security Council.

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# INTERNATIONAL SYSTEM

## CURRENT SITUATION

- **China proclaims its strict adherence to the principles of “state sovereignty” and “noninterference,”** and reluctance to support humanitarian intervention and preemptive action.
  - China’s main concerns are setting a precedent that could be used to intervene—for instance, to support Taiwan or to attack China’s human rights record;
  - China also uses commitment to these principles to defend its unconditional political and economic engagement with pariah nations, such as Zimbabwe, Sudan, and Burma, that are sources of raw materials for China.
- **Nonetheless, China has demonstrated great reluctance to be exposed or isolated as the primary obstacle to a generally accepted international action.**
  - In the UN Security Council when Beijing recognizes it stands alone in opposition to a resolution, it often abstains rather than vetoes in order to safeguard its good relations with the offending state, thereby staying on the correct side of the international community by allowing the resolution to pass.

*China increasingly will face hard decisions whether to accede to international demands for action against offending nations, thereby safeguarding international values and norms, or cling to policies that safeguard its immediate self-interest.*

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### Facts

- *China is a member of more than 130 inter-governmental international organizations.*
- *China is a signatory to more than 250 international multilateral treaties.*
- *Number of times China has vetoed a resolution at the UN Security Council: 4 times (1971–2004).*
- *China abstained on the 1991 vote to authorize the first Iraq War and on the 2004 vote to condemn atrocities in the Darfur region of Sudan.*
- *China has deployed more than 4,000 military personnel on 14 UN peacekeeping missions since 1990.*
- *China is the leading provider of peacekeeping forces among the Permanent Five members of the UN Security Council.*
- *Percentage of UN peacekeeping costs covered by China: 2 percent.*

## IMPLICATIONS

- China supports the international system and appears to have little intention to alter the international system’s rules of the game.
- Nonetheless, **the international community will need to monitor whether the actions of a rising China result in weakening the system,** regardless of Chinese intent.

# CHINA: THE BALANCE SHEET

## JAPAN

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### BACKGROUND

- Although China and Japan have a burgeoning economic relationship, relations in the political, military, and public spheres have significantly deteriorated in recent years as a mixture of heightened pride, self-confidence, and sense of historical grievance has fueled nationalism on both sides.
- **Bitterness in China toward Japan is rooted in Japan's colonization of Taiwan and brutal occupation of China during the first half of the twentieth century;** the Chinese perception of the lack of true remorse in Japan concerning its historical legacy; and fear that Tokyo's failure to account for its past at best shows disrespect for its victims and at worst could permit future aggression.
- **Japan's resentment toward China is driven by Japan's belief that the Chinese Communist Party is using history as a weapon to keep Japan humiliated and subjugated as China rises.**
- A natural sense of **competition persists because China and Japan have never been strong powers at the same time**, and neither wants to be seen as succumbing to pressure from the other.
- In its language and tone, **Beijing betrays confidence that over the course of coming decades, the balance in comprehensive national power between the two countries will shift in China's favor.** Japan senses this attitude, which adds to their sense of resentment and insecurity.

### CURRENT SITUATION

- Recent tensions have been stoked by several events: some Japanese textbooks that whitewash Japanese wartime atrocities; Prime Minister Koizumi's annual visits to the Yasukuni shrine, which commemorates Japan's warrior culture and enshrines 14 "Class A" war criminals from World

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# JAPAN

War II; Beijing's opposition to Japan's bid for a permanent seat on the United Nations Security Council; concern on each side about the other's military modernization; and a territorial dispute in the East China Sea over the Diaoyu (Senkaku, in Japanese) Islands, and the Chunxiao, Duanqiao, and Tianwaitian (Shirakaba, Kusunoki, and Kashi) oil and gas fields.

- **Tensions have manifested themselves in anti-Japanese protests across more than a dozen cities in China in April 2005;** the absence of any senior-level meetings between Japanese and Chinese government officials since Prime Minister Koizumi's visit to Yasukuni in 2001; and military posturing by both sides, including the incursion of a Chinese nuclear submarine off the Okinawan coast in 2004; Japan's identification of China as a potential challenge to its security in its National Defense Program Outline in December 2004; and military escorts for respective energy drilling vessels in the East China Sea.
- Meanwhile, **since the end of the Cold War, Beijing has grown increasingly concerned about the U.S.-Japan alliance's evolution in nature and purpose** as the United States has encouraged Japan to cast off the pacifist constraints of the past 50 years (ironically imposed by a U.S.-drafted constitution) and be a more active security partner in regional and global affairs.
  - Beijing has voiced particular concern over the United States and Japan listing, in February 2005, of "peaceful resolution of issues concerning the Taiwan Strait through dialogue" as a common strategic objective for the alliance.
  - **Beijing views the alliance's development as evidence of a U.S.-Japan containment strategy against China.**

## Facts

- *China-Japan trade: \$189.38 billion (2005)*
- *Growth in trade: +12.7 percent compared with 2004, the seventh consecutive year of rising bilateral trade*
- *China is now Japan's leading trading partner.*
- *Japan is China's second largest trading partner (third including the EU)*
- *Japanese investment in China: \$6.53 bn (2005)*
- *Japan is China's third largest source of foreign investment.*

## IMPLICATIONS

- Given the U.S. alliance with Japan, China-Japan conflict in the East China Sea would pose a substantial challenge to U.S. foreign policy and U.S.-China relations and jeopardize regional peace and stability.
- **China's leadership understands that the Japan issue is politically volatile.** Beijing must give voice to Chinese pride and populist anger over perceived slights, but must also avoid fueling nationalist sentiment to the point of losing control or turning populist nationalism against the Beijing leadership itself.

*Structural problems in the China-Japan relationship are increasing to a point where deeper and more lasting hostility between the two sides is quite possible.*

# CHINA: THE BALANCE SHEET

## KOREA

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### BACKGROUND

- **U.S. and Chinese interests converge on the Korean peninsula in several fundamental respects:**
  - Both seek a stable peninsula free of nuclear weapons;
  - Both support a peaceful resolution of the North Korea nuclear problem through dialogue plus eventual North–South reunification; and
  - Overall neither has much patience for North Korea's ideology, style, methods, closed society, or regime.
- **Nonetheless, U.S. and Chinese interests over Korea diverge in several key respects:**
  - While the United States places a premium on nonproliferation, human rights, and (arguably) regime change, China's interest in stability trumps these objectives;
  - China remains concerned that Korean reunification could bring U.S. forces closer to its border; and
  - Beijing also worries that turmoil in North Korea could spawn a massive influx of refugees across the border.

### CURRENT SITUATION

- **While China often faults the United States for its “hostile” attitude toward the North, Beijing bristles at Pyongyang's dangerous brinksmanship**, which places Northeast Asia in the spotlight of Washington's security agenda and creates unnecessary regional and U.S.-China tensions.

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# KOREA

- China has consistently demanded that the North Korean nuclear impasse be solved peacefully through dialogue.
- **Beijing has urged Pyongyang to follow China's economic reform and political control model**, which it believes could maintain North Korea's viability over time while reducing the drain on Chinese resources.
- At the same time, **China's relations with South Korea have warmed markedly in recent years**, fueled by:
  - their substantial economic (trade and investment) relationship; and
  - their common concerns, as compared to the United States and Japan, about the cost to their societies of instability on the peninsula.

## IMPLICATIONS

- **Concerns that turmoil in North Korea could foment unrest among the ethnic Korean population along its northeastern border with the peninsula, cause China to be much warier than the United States about using direct action to pressure Pyongyang**, whether through military force, sanctions, isolation strategies (including the Proliferation Security Initiative), or other such policies.
- **While it is true China could do more to bring North Korea to heel on the nuclear question, it is unlikely that Beijing has the influence to force Pyongyang against its wishes to give up its one diplomatic and military trump card**, even if Beijing considered it in its interest to take more assertive action.
  - Chinese officials note that **sanctioning North Korea, would prove dangerous and counterproductive** as they would lose any ability to exercise influence on Pyongyang and would drive the regime into a corner.
  - **An open demonstration of Pyongyang's nuclear weapons capability, however, will force China to act**, owing both to its professed commitment to nonproliferation norms and to Beijing's worry about the prospect that such a clear demonstration of North Korea's nuclear weapons capability could lead Japan (and perhaps Taiwan) to reconsider their nonnuclear posture.
- Improving Sino-South Korean relations have led to questions about whether Beijing is taking advantage of recent tensions in South Korea's relations with the United States to drive a wedge in the U.S.-ROK alliance.
  - **South Korea will likely accommodate more readily to China's rise than, for example Japan. However, Seoul will likely want to maintain its alliance with the United States as a strategic hedge**, particularly if Seoul is not forced to support a hostile U.S. posture toward China (and North Korea).

## Facts

- *China-South Korea trade: \$111.9 billion (2005)*
- *South Korea is China's sixth largest trading partner.*
- *China is South Korea's leading trade partner*
- *South Korean investment in China: \$5.17 billion (2005)*
- *South Korea is China's fourth largest source of investment.*
- *China-North Korea trade: \$1.58 billion (2005)*
- *China is North Korea's leading trade partner.*
- *North Korean migrants residing in China: 30,000-50,000*
- *North Korea receives a third of its food and more than two thirds of its fuel from China.*
- *Ethnic Koreans living in China: 2 million*

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*China's interest in stability trumps its commitment to a nuclear weapons-free peninsula or regime change in North Korea, which is a fundamentally different perspective from the United States on the issue.*

# CHINA: THE BALANCE SHEET

## MILITARY MODERNIZATION

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### BACKGROUND

- **China has justified its military modernization as the reasonable action of a major power seeking to update antiquated weapons systems and equipment and rationalize an outdated military structure.**

China's military modernization has been driven by:

- **The need to ensure the protection of national sovereignty and territorial integrity**, which has translated in large part into preparations for a Taiwan scenario;
- **Observations of U.S. military operations over the last decade**, including the 1991 Gulf War and 1995–1996 Taiwan Strait crisis. These operations were wake-up calls to the Chinese leadership and to the People's Liberation Army (PLA) concerning their ability to handle a Taiwan scenario, including potential U.S. intervention.
- In 1999, assessments of political trends in both Taiwan and the United States led Beijing to renew and accelerate its emphasis on comprehensively developing and recalibrating **China's military** in doctrine, training, education, force structure, and overall operational capability.

### CURRENT SITUATION

- **China's 2004 White Paper introduced a new concept of preparing to fight "local wars under conditions of informationalization," demonstrating Beijing's recognition of information technology's growing importance in modern warfare**, as reflected in U.S. military operations over the past decade.

For further information, see Chapter 5:  
"China's Foreign & Security Policy: Partner or Rival?"

*China: The Balance Sheet: What the World Needs to Know Now about the Emerging Superpower*

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# MILITARY MODERNIZATION

- **China's doctrine of "active defense" seeks to take the initiative and to stay on the offensive from a conflict's earliest stages** in order to bring hostilities to a swift conclusion.
- **China is focusing intently on anti access area-denial strategies**, procuring platforms with the capability and intention to deter, prevent, or complicate the intervention of the United States (or others) in a Taiwan scenario.
- **China's security focus has shifted from continental concerns to its maritime periphery**, leading to a growing emphasis on China's air and naval capabilities, and China's strategic missile forces (Second Artillery).
  - The PLA is upgrading its longer-range missiles on land and (under)sea by extending their reach, shifting from liquid- to solid-fuel, and improving precision guidance. China's long-range missiles are expected to be able to reach the entire continental United States as early as 2010.
- **China's military budget is open to significant debate**, given the lack of transparency in China's military establishment, and its tendency to underreport defense spending, given the exclusion of a number of defense items from the budget.

## IMPLICATIONS

- Beijing seems to understand its limitations at present. **Chinese leaders have no illusions that the PLA is a match for the U.S. military**, or that the PLA will catch up in the foreseeable future and measurably narrow the gap in comprehensive national power for at least decades to come.
- **What China does seek to do is to focus on niche capabilities and vulnerabilities of the United States to at least deter, complicate, and delay, if not defeat, U.S. intervention in a Taiwan scenario**, while more broadly preventing the United States and its allies from containing China's development through military action or intimidation.
- **Although a Taiwan scenario may serve as a leading motivator for China's military modernization, operational capabilities developed in the process need not be confined to Taiwan but may have broader applications to assert Chinese interests beyond the Taiwan Strait.**
  - China's military development will also have an impact on the overall regional balance of power that will require, at least, greater transparency to provide sufficient reassurance to other states concerned about the rising giant on their shores.

## Facts

- *China's 2006 defense budget: \$35.1 billion*
- *Percentage change over previous year: +14.7 percent*
- *China's military comprises four services (distributed across seven military regions):*
  1. *Peoples Liberation Army (PLA);*
  2. *PLA Navy (PLAN);*
  3. *PLA Air Force (PLAAF);*
  4. *Second Artillery (nuclear weapons and missiles)*
- *China's military cut its forces by 200,000 to 2.3 million active-duty personnel in 2005.*
- *Combined with the paramilitary People's Armed Police (PAP), China's military exceeds 3.2 million personnel.*
- *China also has around 10 million organized militia members throughout the country.*
- *China has conducted joint military exercises with 11 countries since 2002.*
- *Leading sources of China's conventional arms imports: Russia, Ukraine, Israel, France (2000–2004).*
- *Leading recipients of China's conventional arms exports: Pakistan, Egypt, Iran, Algeria (2000–2004).*
- *China has deployed more than 4000 military personnel on 14 UN peacekeeping missions since 1990.*

# CHINA: THE BALANCE SHEET

## U.S.–CHINA RELATIONS

The direction that China and U.S.-China relations take will define the world's future. For the United States, a rising China increasingly affects American prosperity and security, calling for some clear-eyed thinking and tough economic, political, and security choices. As the twenty-first century unfurls, the stakes have never been higher for getting U.S. policy toward China right. By untangling the complex, sometimes contradictory, strands of this vast and dynamic country, *China: The Balance Sheet* lays the foundation for informed and effective U.S. policy toward China, the world's emerging superpower.

### ARE CHINA AND THE U.S. DESTINED TO BECOME ENEMIES?

Despite what realist international relations theory might say about the inevitable clash between rising and status quo powers, nothing preordains that the United States and China will become enemies. In fact, it is profoundly in the interest of both sides to prevent this. Bilateral economic ties are expanding rapidly as each side relies increasingly on the health of the other for its own economic security. Transnational threats such as drugs, piracy, infectious disease, environmental degradation, and radical jihadism require (at least) bilateral cooperation. The two sides will have a common interest in ensuring adequate global energy supplies, their efficient consumption, and the development of clean energy alternatives. Beijing will be consumed with a series of difficult domestic transitions that will require a peaceful international environment and good relations with the United States in particular, for the foreseeable future. The United States will be focused on threats from rogue regimes, failed or failing states, non-proliferation challenges, and a fanatical ideology bent on its destruction, against which Washington will need substantial international cooperation, including from China.

Meanwhile, growing social and cultural contacts and educational exchanges help to overcome potential misunderstandings that can breed emotional antagonisms. Indeed, neither side's population is inclined instinctively to view the other as an enemy. Nonetheless, economic integration and social ties are not necessarily enough to prevent official miscalculation, mistrust, clashing interests, or populist emotions on either side from plunging the relationship into crisis, if not into conflict, in coming years. Historians will note the example of Europe before World War I as a cautionary tale in this regard.

The rise of China will require a change in the respective psychologies of the two sides to prevent the development of serious tensions in the relationship. Beijing, for instance, can no longer affirm credibly that a foreign policy premised on a desperate need for internal development is a purely domestic matter that does not affect the

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## U.S.—CHINA RELATIONS

security of others, particularly when it facilitates the violation of international norms by unsavory regimes. Nor can Beijing aver that its power and influence in international affairs is minimal because of a “developing world” self-image. The policies and actions of a nation of 1.3 billion people necessarily will affect the management of a peaceful and stable global system. As China rises, Beijing will need to acknowledge this fact and assume greater responsibility to act in ways that reinforce international norms above and beyond its immediate self-interest—becoming what Deputy Secretary of State Robert Zoellick calls a “responsible stakeholder.” Failure to do so will create frictions not only with the United States but also with others whose security and interests are tied to the international system.

Likewise, Washington will need to be psychologically prepared for the impact China’s rise may have on the relative power and influence of the United States in East Asia and beyond. While China is unlikely to challenge this preeminence in political, economic, or military power fundamentally for the foreseeable future, the rise in China’s relative power will likely lead to, or at least be associated with, economic dislocations in the United States and may alter U.S. strategic relationships with friends and even allies around the world as nations accommodate themselves to China’s new status.

The temptation for the United States to fall back on an actively hostile or antagonistic posture toward Beijing as a result, however, is a dangerous one for U.S. interests. Without serious provocation from Beijing, such a policy would isolate the United States and put Washington at odds with allies and friends around the world who will rely increasingly on China, economically and otherwise. To safeguard its long-term strategic position, therefore, Washington must consider the implications of its China policy on its strategic relations with other nations. The United States should remember that the international community is as uncertain and concerned about the implications of China’s rise for their interests as is the United States and will support, if sometimes tacitly, reasonable U.S. moves to prevent the development of an irresponsible or dangerous China.

In fact, there is nothing inherently nefarious or unnatural about China’s ambitions to become a major power given its size, location, and history. A strong and prosperous China could add a major new market and strategic asset to global growth, development, scientific discovery, and strategic stability. Nonetheless, the uncertainty of China’s future is an inescapable component of the U.S.-China relationship, since no one—not even the Chinese—can predict for certain the trajectory of China over time. The United States and others will necessarily hedge against worst-case scenarios resulting from China’s rise, and the Chinese will need to understand and not overreact to such policies.

Similarly China has fundamental uncertainties and suspicions about U.S. intentions that will need to be broached openly, both publicly and privately, and discussed in a spirit of candor and good faith.

In the end, however, Washington and Beijing will continue to have clashes of interest and vision in coming years under the best of circumstances, particularly as China becomes a stronger and more assertive and influential player on the international scene. Differences in values, culture, historical experience, and political system will also pose substantial challenges to the relationship, and frictions will be inevitable. It is urgent, therefore, that neither side adds to the burden by injecting artificial or emotional elements into the mix. More informed public discussion, debate and education about China will be required in the United States. Beijing must be careful about its public rhetoric, through its media and otherwise, to provide accurate and balanced information and must avoid enflaming popular opinion in China concerning the United States. Sober-minded management of this critical relationship in coming decades will be the ultimate challenge for both societies as they navigate a delicate period of transition with serious implications not only for the two sides but also for the stability and well-being of the global community as a whole.