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# CHINA

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China is a giant screen upon which outsiders project their hopes and fears. Expectations of economic gain coexist with worries about financial crisis; shrill alarms about Chinese power with dire forecasts of collapse; visions of democratic change with caricatures of current reality. It is time to step back and look at where China is today, where it might be going, and what consequences that direction will hold for the rest of the world.

*by David M. Lampton*

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## **China Is a Rogue State with Hegemonic Ambitions**

**Not true.** Strident voices in the West assert that the People's Republic of China (PRC) sees little to be gained from being a good international citizen. This view has three defects: 1) The record of the last two decades does not support it; 2) it is not in Beijing's interest to be perceived and treated as a rogue state; and 3) if other nations begin to regard it in that light, they will help bring about the very Chinese behavior they seek to avert.

Consider China's actions as a permanent member of the UN Security Council. Surely, "the next 'rogue' superpower"—to quote one recent characterization of China in the U.S. press—would not have hesitated to throw its weight around over the years. Yet, since 1972, while China has abstained on some Security Council resolutions, it has cast only two vetoes in open session. Although deeply apprehensive of resolutions condoning sanctions or interventions, the PRC has not

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sought to stop UN missions in the former Yugoslavia, Haiti, Somalia, or Iraq during the Gulf War and thereafter. As Foreign Minister Qian Qichen said in late 1997 about Beijing's position on sanctions against Iraq: "Despite the fact that we have not supported these [UN] resolutions, they must be respected."

This generally constructive stance extends to the growing number of international organizations that China has joined since former leader Deng Xiaoping's opening to the outside world almost two decades ago. In 1977, China belonged to 21 international governmental organizations and 71 international nongovernmental organizations. By 1994, the respective numbers were 50 and 955. In institutions such as the Asian Development Bank, the International Monetary Fund (IMF), and the World Bank, China has been a model citizen. Beijing has also acted responsibly in Asia's recent economic crisis, contributing U.S.\$1 billion to the IMF stabilization package for Thailand, clearly conveying its intention to defend the Hong Kong dollar, and (so far) resisting the temptation to devalue its own currency.

Closer to home, the record is mixed. But Beijing's missile exercises in the Taiwan Strait in 1995–96 and its occupation of several reefs in the Spratly Islands must be set next to its concerted and successful efforts during the last decade to improve relations with every country in the neighborhood. In Cambodia, China played an essential role in the settlement leading to UN-sponsored elections. Looking north and west, the PRC has resolved disputes with Kazakstan, Kyrgyzstan, Russia, and Tadjikistan through negotiated agreement. To the south, Beijing has improved relations with Hanoi and New Delhi and joined the Association of South East Asian Nations' regional forum on security.

Beijing's adherence to various international institutions, treaties, and regimes has been best where it has been engaged in writing the rules it is asked to observe and where the international community has made available tangible resources to assist implementation. Indeed, for all the controversy surrounding China's behavior in the field of nonproliferation, it has generally complied with the international nonproliferation regimes to which it has been a full party, including the Treaty on the Non-Proliferation of Nuclear Weapons, the Comprehensive Test Ban Treaty, and the Chemical Weapons Convention. China's relations with Pakistan and Iran have been worrisome. Nonetheless, Beijing addressed these issues during President Jiang Zemin's October 1997 state visit to the United States and reas-

sured the Clinton administration in writing about China's future nuclear cooperation with Iran.

Beijing's compliance has been less praiseworthy in areas where it has not been a member of the rule-writing club, where compliance would conflict with its perceived strategic interests, or where it lacks the necessary resources and enforcement mechanisms. In the case of some missile-related and nuclear technology transfers to Pakistan—long a Chinese strategic ally—Beijing has sought to use its compliance with agreements, or lack thereof, as leverage to obtain stricter adherence in Washington to the Joint Communiqué on Weapons Sales to Taiwan of 1982. Then again, the transfer of ring magnets to Pakistan probably owes less to government directives than to Beijing's inability to exercise effective supervision and control over industries and companies—a problem that bedevils the United States, Great Britain, and other countries with a strong stake in nonproliferation.

## **China Is Undertaking a Huge Military Buildup**

**Wrong.** There is little uncertainty about China's modest military capabilities, much speculation about what those capabilities may be 20 years hence, and considerable debate about current and future Chinese intentions.

China's defense budget presents a daunting challenge for analysts, not least because much military spending occurs outside the regular defense budget. Those who wish to point to a Chinese threat often use figures from China's defense budget that show a dramatic rise in official spending from 1988 to 1996. However, a 1997 RAND study of China's official defense budget, which adjusts these figures for inflation, suggests that the increase in official defense spending is much less significant.

The Institute for International Strategic Studies and the Stockholm International Peace Research Institute assert that total spending by the People's Liberation Army (PLA) is four to five times the amount officially reported (which Chinese military officers hotly dispute). If true, this would put actual 1996 PLA spending at U.S.\$35.5 to 44.4 billion. The Heritage Foundation puts the upper range estimate at U.S.\$40 billion. Japan, in 1996, with the American nuclear umbrella and the U.S.–Japan Security Treaty, spent about U.S.\$45 billion. China has a long coastline, land borders with 14 states, many of which have presented, and might again present, security problems, and no protective

alliance; the PLA also has domestic control responsibilities (as we saw tragically in 1989). And not only do many of China's neighbors have more modern weapons, but as a report recently issued by the Pacific Council on International Policy and RAND noted, "China's military expenditures as a percentage of total defense expenditures by all Asian countries have been decreasing steadily since the mid-1970s."

What about China's development and purchase of advanced technologies? A 1996 report by the U.S. Department of Defense covering 17 families of technologies with military applications shows that, with a few important exceptions (nuclear and chemical technologies among them), China lagged well behind first- and second-tier countries such as France, Israel, Japan, Russia, the United Kingdom, and the United States. True, current estimates of Chinese purchases of advanced technology from Russia during 1990–96 ranged from U.S.\$1 to 2 billion annually. By way of comparison, however, the U.S. military spent U.S.\$11.99 billion with one American prime defense contractor, Lockheed Martin, in FY 1996 alone.

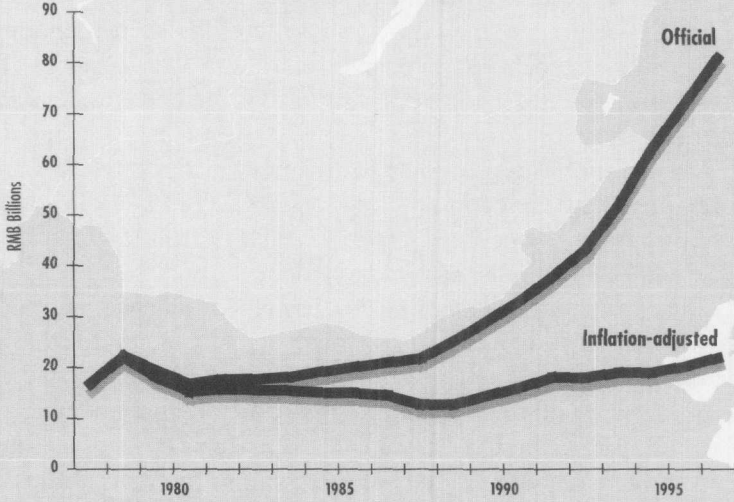
While it would be foolish to dismiss China's increasing ability to project force beyond its borders and to affect U.S. and other interests, it would be even more foolish to allow exaggerated perceptions of Chinese strength to shape U.S. policy—a development that would stoke nationalist resentment in Beijing and likely fuel support for the very buildup that some U.S. commentators regularly decry.

## **A Peaceful Resolution of Taiwan's Status Is Only a Matter of Time**

**Maybe not.** The conventional wisdom is that the Taiwan Strait missile crisis from mid-1995 to March 1996 had a sobering effect on Beijing, Taipei, and Washington. In Beijing, there had been those who thought that Washington lacked the will to uphold its commitment to a "peaceful resolution" of the Taiwan issue and to stability in East Asia. The March 1996 dispatch of two aircraft carrier groups was a credible assertion of American interest. In Taipei, President Lee Teng-hui and others seemed to have concluded that Beijing could not, or would not, do much about Taiwan's search for a more dignified international role. Beijing's missiles and the resultant dislocations of markets and capital flight were an abrupt comeuppance. And after the PRC missile exercises (particularly those in the spring of 1996), many in the U.S. Congress

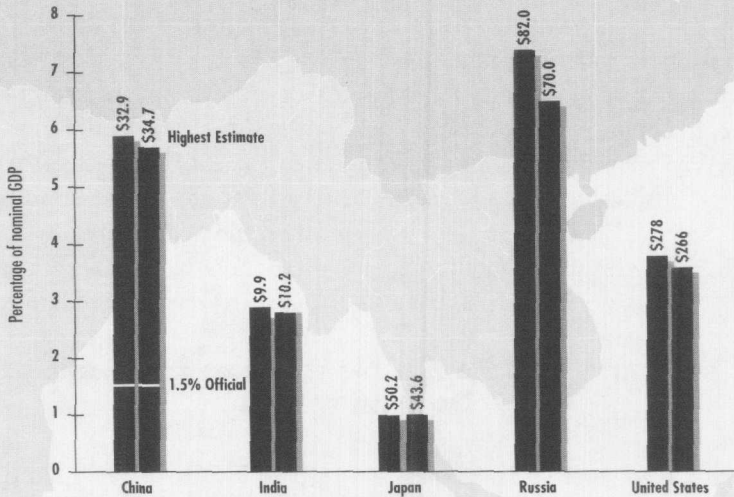
## China: Less of a Threat Than It Seems?

China's Defense Budget in Billions of Renminbi (RMB),  
Official Figures, and Official Figures Adjusted for Inflation



Source: James Mulvenon, the Rand Corporation.

## Defense Spending as a Percentage of GDP and in Absolute Numbers, 1995-96



Source: *The Military Balance: 1997/98* (London: International Institute for Strategic Studies, 1997).

Note: The figures above each column report defense expenditures, according to NATO definitions and are converted to billions of U.S. dollars.

professed a new appreciation for Beijing's sensitivity to the Taiwan issue. In short, there is now a happy assumption that everyone has become more cautious. One can hope so, but there are other forces at work.

First, something fundamental drives Taipei's search for a greater role in the international community—a changing sense of identity among its population. In recent years, there has been a progressive decline in the percentage of people on Taiwan who consider themselves “Chinese” and a corresponding rise in the percentage identifying themselves as “Taiwanese.” Taiwan's ever more competitive political system has given voice to this new, distinct identity. In the Taiwan presidential election of the year 2000, a president may well be elected from the Democratic Progressive Party (DPP), which historically has stood for the island's independence.

Beijing has said it will employ force to prevent independence or outside intervention. How Beijing would actually react to the DPP's assumption of power, how the DPP would lead Taiwan, and how the Taiwanese will respond in an indefinite future are all imponderables. And yet, the answers to these questions will influence whether peace and stability can be maintained in the Taiwan Strait in the years ahead.

There is another part to the equation: How long will Beijing remain “patient?” As Beijing's attention shifts from the return of Hong Kong and Macao (in 1999), it will focus increasingly on “reunification with Taiwan.” Not only do PRC leaders worry about trends on Taiwan, they believe that, were the island to achieve *de jure* independence, their own right to rule would be forfeited. Moreover, they fear that areas from Mongolia to Xinjiang to Tibet would use Taiwan's moves to justify their own efforts to break away. Beijing sees everything at stake in the Taiwan issue and is unsure that time works in its favor, despite the ties that about U.S.\$35 billion in investment by Taiwan on the mainland create.

In short, continued stability depends on restraint by Beijing, Taipei, and Washington, none of which has an unblemished record of self-control.

## **China Will Be the Next Asian Economic Domino to Fall**

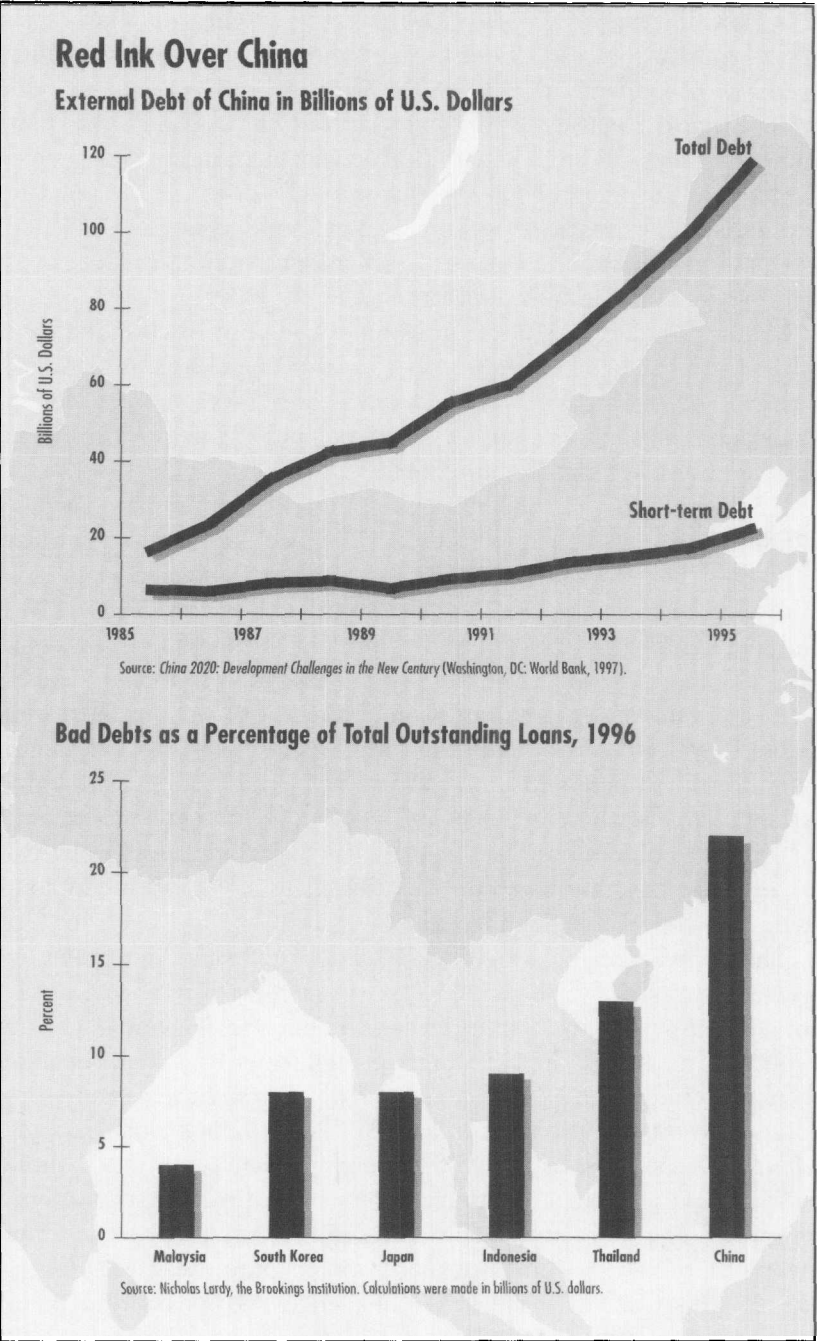
**Not necessarily.** The financial crash in Northeast and Southeast Asia since mid-1997 is already taking a toll on the PRC. China now faces the prospects of declining regional demand for its exports and stiffening competition from regional economies in other export mar-

kets. Its still robust 1997 GDP growth of 8.8 percent was below earlier government forecasts, there are signs that growth will slow further (perhaps to 6 percent), and some Chinese and foreign analysts believe that the PRC may devalue its currency to maintain its export competitiveness. Beijing asserts that it will vigorously resist such a move. Yet, if unemployment rises, growth slows, and domestic exporters apply political pressure, policy could change. Declining asset values in East and Southeast Asia will probably also reduce capital flow to China from the region.

Many of the considerations that have undermined confidence in other Asian financial systems apply to China: a lack of transparency; financial cronyism; banks with huge portfolios of nonperforming loans; poor regulatory systems; property bubbles; heavy borrowing abroad; and new, volatile equity markets.

And yet, China's economy has important differences that may provide a breathing spell. In a forthcoming book, economist Nicholas Lardy lays them out clearly: 1) China's currency is not freely convertible, thereby reducing speculative pressures; 2) Beijing reports hard currency reserves of about U.S.\$140 billion, not including the separate resources of Hong Kong; 3) a large proportion of foreign investment in China has come in the form of direct investment in factories and other assets, not hot money put into more volatile stock markets; 4) although Chinese entities have large foreign debts, most are long-term, unlike elsewhere in Asia; and 5) although foreign direct investment has been important for growth over the last 15 years, the high domestic savings rate has been the principal fuel—growth can continue if savings can be more productively utilized.

The key to avoiding a meltdown will be whether Beijing moves to accelerate reform of the banking and state enterprise sectors—an apparent commitment of the current leadership. But deciding and doing are two different things: Will Beijing recapitalize its banks and operate them on sound financial principles? Simply training the personnel to accomplish this is a gargantuan task. And will China tackle the problem of state enterprises (at least 40 percent of which lose money), whose bad debts to the banks are a principal cause of the financial system's current woes? The restructuring of state enterprises and the bankruptcy of many others could put millions more workers onto the streets, just as growth slows. Can China meet these challenges and avoid serious political dislocation? Nobody can be sure.





## **China's Large, Fast-Growing Exports Come Principally at the Expense of Jobs in the West**

**Wrong.** Chinese exports to the United States and Europe have grown rapidly and often dominate in labor-intensive sectors such as toys, footwear, apparel, and textiles. But PRC exports in these areas generally surged after domestic jobs in these industries had already migrated to Indonesia, South Korea, and Taiwan, and elsewhere in East Asia and Latin America. In garment manufacturing, for example, World Bank data suggests that, especially for the European Union, employment had already fallen sharply before Chinese exports achieved even the relatively low penetration rate of 2 percent. And economist Marcus Noland calculated that from 1988 to 1994, almost 90 percent of the increase in the Chinese share of U.S. consumption had merely displaced imports from other countries. The real fear of Chinese export competition ought to be found in low-cost producing economies, not Main Street, U.S.A. or Europe.

## **China Has Been a Bust for U.S. Firms**

**Not really.** According to U.S. Commerce Department figures for 1990–96, China was the fastest-growing major U.S. export market. During that period, American exports grew at a compound rate of more than 19 percent, if one includes U.S. exports initially exported to Hong Kong but then reexported to China. The PRC is now America's ninth largest export market. By way of comparison, U.S. exports to Japan grew at 6 percent, and those to Brazil by 15 percent, annually. American-invested joint ventures and wholly owned U.S. subsidiaries in China also increasingly sell goods there; although some of the profit is repatriated to the United States, much is reinvested in China, where it can generate future returns.

However, it is also true that the United States has a mounting trade deficit with China—U.S. government estimates peg it at about U.S.\$50 billion for 1997—a figure that many economists believe overstates the problem. The reality of these rising exports to China and the simultaneously mounting trade deficit suggest that Washington—quite appropriately—is proceeding to secure more market access.

Those who assert that the Chinese market has been a bust have a deeper, more erroneous point. Their implicit assumption is that the United States and other industrialized economies do not have a lot rid-

ing on economic relations with China. Wrong. Everyone has a great deal at stake in whether or not China can sustain (and how it sustains) growth as other economies deflate.

## **China Is the World's Biggest Intellectual Thief**

**Wrong, for now.** Stealing copyrighted music, software, and movies—the “piracy” of intellectual property rights (IPR)—is a serious and legitimate concern. One 1996 study estimated that “of the 523 million new business software applications used globally during 1996, 225 million units—nearly one in every two—were pirated.” China does its share of wrongdoing in this regard. But the sorry fact is that developed nations and Americans themselves inflict the biggest dollar losses on U.S. industry, though the highest piracy rates (the percentage of protected items in use that have been illegally appropriated) are to be found in low-income economies with weak to nonexistent legal structures.

Looking at dollar losses through software piracy in 1996 (and the industry’s methodology is subject to criticism for inflating losses), Eastern Europe, Japan, Western Europe, and the United States itself all inflicted greater losses on U.S. industry than China (with 22 percent of the world’s population). However, if one looks at the “piracy rate” in 1996, China was surpassed only by Vietnam and Indonesia. Russia and the rest of the Commonwealth of Independent States were close behind.

In short, owners of intellectual property confront a global circumstance in which losses to developed countries (with high rates of personal computer ownership) exceed losses to poorer countries (with fewer PCs, weaker legal and regulatory structures, and more extensive official corruption).

The music recording industry faces similar problems. The Recording Industry Association of America reported in 1996 that lost revenue through CD piracy in Japan came to U.S.\$500 million annually—“more than the U.S.\$300 million the American record industry says it is losing annually from the far more well-known piracy in China.”

China is trying to build an IPR enforcement regime. In addition to constructing a (yet imperfect) framework of domestic law in the late 1980s and 1990s, Beijing signed two agreements with Washington (in 1992 and 1995) and from May 1996 to March 1997 closed 37 factories illegally copying CDs—58 CD and CD-ROM production lines by January 1998. As China develops its own innovators and artists with commercially salable products, demands for stricter IPR protection will grow.

## **China is a Totalitarian State**

**Simplistic.** To reject this characterization is not to assert that the PRC is a democracy—it is not. But words should have meaning. Totalitarian refers to a state that has the intention and capability to control nearly all aspects of human behavior, thought, and communication. Totalitarian described the ambitions and, to a considerable extent, the system during much of Mao Zedong's reign, when a trip to Albania was considered broadening and children were expected to inform on parents.

Ironically, many of China's domestic problems and irresponsible behavior abroad—from piracy to proliferation—stem from a lack of central control. Most significantly, between 30 and 200 million people slosh around China in search of temporary employment, encamping in and around cities and creating a potentially volatile pool of poor and discontented citizens.

In fact, for all its imperfections and injustices, China today is freer than it has been at any time in the last five decades. About 40,000 Chinese students are now enrolled in tertiary U.S. educational institutions; during the Soviet Union's entire 70-year history, it never sent that many students to the United States. In 1965, there were 12 television and 93 radio stations in China; today, PLA receiving dishes are sold illegally to citizens who pull in satellite TV. The Internet is growing by leaps and bounds. Newspapers and magazines have become not just more numerous but far more diverse and autonomous. In 1978, the state controlled more than 90 percent of GNP; in 1996, that number was about 45 percent and falling. The state now employs only 18 percent of the work force, compared with more than 90 percent in 1978 (including peasants in communes at that time). In September 1997, at the Fifteenth Party Congress, the concept of "public" ownership was morphed from Marx's concept into "public" in the sense of "initial public offering" of stock. While under Mao the concept of the individual suing the state for damages was inconceivable, it now happens increasingly often.

## **China Is Wrecking Hong Kong**

**No.** The broadcast networks that spent large sums covering the July 1, 1997, handover to the PRC left disappointed, not at the absence of disaster but at the absence of a "story." The days since then have been notable for both what Beijing has and has not done.

## China through Rogue-Tinted Glasses

*Excerpts from House Democratic Leader Richard A. Gephardt's address to the Detroit Economic Club on May 27, 1997:*

"The United States has no business playing 'business as usual' with a Chinese tyranny that persecutes Christian and Muslim leaders and leaders from many other faiths, precludes tens of millions from practicing their religion, sells the most lethal weapons to the most dangerous of nations, profits off slave labor, and engages in the utter evil of forced abortion. . . . Today's China is not content to keep its reign of terror inside its own borders. It blows its storm of calamity into the world's other outlaw nations. . . .

"The totalitarians who rule China—and we should not be afraid to call them that, as Ronald Reagan was not afraid to speak of the Evil Empire—openly express their contempt for the ideals of freedom. . . . A government that can arbitrarily violate the liberty of its people cannot be trusted to abide by the rules of contract or the rights of companies. . . .

"And what have we gained by trafficking with a tyranny that debases the dignity of one-fifth of the human race? What is gained by a policy that sees all the evils and looks the other way? What is gained by constructive engagement with slave labor? Our trade policy with China has failed. It has failed not only on moral grounds but economically as well. There is nothing 'free' about our trade with China—in fact, it comes to us at great cost and little benefit. . . . They send more than a third of their exports to our shores while less than 2 percent of our products go there. . . .

"China has said to many of our companies that if they want to sell there, they must produce there. Then they have ordained that in order to build factories there we must transfer our technological know-how to them. Business is being blackmailed into giving China the means and the trade secrets that will make them an economic powerhouse. And in return they will continue to pirate our music, software, and videos. . . ."

Beijing has not militarized the city, as some feared. There are fewer army troops there under Chinese rule than there were generally in Hong Kong under British governors—reinforcements are, of course, only a few miles away in China proper. Beijing has not stopped political demonstrations, which have continued on an almost daily basis since the night

of June 30–July 1, 1997, when Martin Lee, the leader of democratic forces in Hong Kong, spoke to a crowd from the balcony of the Legislative Council. Although it is hard to measure press self-censorship—and there is some, as evidenced by the reluctance of Hong Kong Chinese to show three controversial movies dealing with sensitive subjects—Hong Kong still has one of the most freewheeling journalism communities in Asia. In terms of governance, it appears that the new chief executive, C.H. Tung, has great latitude in leading Hong Kong.

U.S. naval ships have been permitted to continue to make port calls—as of January 1998, 34 naval vessels, including two aircraft carrier battle groups and two nuclear submarines. When equity and property markets throughout the region, including Hong Kong, precipitously declined in the latter half of 1997 and early 1998, Beijing let markets work (even though many PRC interests lost heavily). Chinese leaders also quietly let it be known that China's large hard-currency reserves could be brought to the defense of the Hong Kong–U.S. dollar peg.

Less reassuring has been Beijing's determination, expressed well before the takeover, to reverse British governor Christopher Patten's October 1992 speedup in the agreed-upon process of broadening the popular franchise. Instead, immediately after the handover, a provisional legislative council was installed to sit during the interim period before new elections. The elections that Tung has announced for May 1998 will be widely criticized for narrowing functional constituencies and employing proportional representation in ways that can be expected to weaken the power of Martin Lee's Democratic Party.

On balance, however, Beijing has played a responsible role. This pattern of PRC behavior probably will persist, depending on the fate of China's own reforms, regional economic stability, and whether Hong Kong's own people stay out of the business of promoting political change in the PRC.

## **China Is an Effective, Major Player in the Washington Lobbying Game**

**Wrong.** No misconception is further from reality. Until May 1995, when Lee Teng-hui was given a visa to visit Cornell University as a result of congressional pressure (by a House vote of 396–0), Beijing paid little heed to Capitol Hill. PRC leaders rested secure in the mistaken belief that when U.S. presidents wish to prevail over Congress, they do.

This inattention to Congress is reflected in a number of ways. Beijing has one law firm under retention in Washington—Taipei is reported to have 14. The PRC has (off and on) one public relations firm in the United States—Taipei has many. Even if one adds to the PRC's legal lobbying expenditures the alleged U.S.\$100,000 in illegal campaign contributions that the FBI says may have occurred (although the Thompson committee failed to demonstrate this), China does not rank even among the top 10 nations (or territories) in terms of lobbying efforts. Even Haiti (no. 7) and Angola (no. 9) outspend Beijing!

The PRC recently augmented efforts to bring members of the U.S. Congress to China. Beijing knows that there has been high congressional turnover since 1992, that most members have not traveled much, and that seeing China's dynamism leaves few views unchanged. But the PRC efforts lag well behind Taipei's. In 1996, members of Congress took 58 all-expense paid trips to China—still a distant second to the 139 trips they took to Taiwan. When the numbers for 1997 are in, Beijing probably will be seen to have narrowed the gap considerably.

### **China Is an Environmental Accident Waiting to Happen**

**Wrong; it is happening.** Many concerns with respect to China are exaggerated, but this one is underestimated by most outsiders. The human and economic costs of air and water pollution in China are staggering. China's urban residents breathe air that significantly exceeds the World Health Organization's minimal air quality standards.

The long-term health effects (such as mental retardation attributable to excessive lead concentrations in the blood of children) are becoming all too apparent. The death rate from chronic obstructive pulmonary disease is five times that of the United States. The World Bank says that simply reducing outdoor pollution levels to the Chinese government's standard would save 178,000 lives annually. Beyond the direct monetary expenses (such as additional hospital admissions), there are other costs: lost work time due to sickness; decaying infrastructure from acid rain; lost crops and farmland; and forfeited tourist revenues. The World Bank concluded that "total air and water pollution costs are conservatively estimated at U.S.\$54 billion a year, or roughly 8 percent of GDP." China's GDP growth rate has averaged about 10.2 percent over the last 11 years, suggesting a star-

ting conclusion: More than three-quarters of China's real GDP growth has been offset by the above costs since 1985.

Those figures do not account for the costs inflicted by PRC pollution on countries near and far, effects stemming from acid rain, carbon dioxide emissions, and ozone depletion. China's rapidly growing greenhouse emissions, and the burden Beijing should assume to reduce them, were among the principal conflicts at the Kyoto Conference on global warming. And as Charles Johnson of the East-West Center recently observed, "If China follows the pattern of wealth first, cleanup later like its neighbors Japan, South Korea, and Taiwan, even its most affluent coastal provinces probably will not start seriously tackling air pollution for 10 or 20 more years."

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## WANT TO KNOW MORE?

Rapid changes within China and in its global interconnections are the focus of much new research. One of the most comprehensive of such pieces is ***China 2020: Development Challenges in the New Century*** (Washington, DC: World Bank, 1997), an overview volume that summarizes key findings from six companion volumes. For those interested in governance in China, see Kenneth Lieberthal's ***Governing China*** (New York, NY: W.W. Norton & Company, 1995). For the best available account of China's foreign policy in the era of reform, see Andrew Nathan & Robert Ross, ***The Great Wall and the Empty Fortress*** (New York, NY: W.W. Norton & Company, 1997). For a wide-ranging overview of the issues shaping Sino-American relations in the Clinton era, see ***Living With China***, edited by Ezra Vogel (New York, NY: W.W. Norton & Company, 1997). To learn more about China's military expenditures and the business enterprises of the PLA, consult James Mulvenon's ***Chinese Military Commerce and U.S. National Security*** (Santa Monica, CA: RAND Corporation, June 1997). And for a comprehensive, readable overview of China's changing role in the world economy, see Nicholas Lardy's ***China in the World Economy*** (Washington, DC: Institute for International Economics, 1994).

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