

CHAPTER 2

CHINA'S GLOBAL AND REGIONAL ACTIVITIES AND OTHER GEOSTRATEGIC DEVELOPMENTS

SECTION 1: CHINA'S REGIONAL ACTIVITIES

The Commission shall investigate and report on “REGIONAL ECONOMIC AND SECURITY IMPACTS—The triangular economic and security relationship among the United States, [Taiwan] and the People’s Republic of China (including the military modernization and force deployments of the People’s Republic of China aimed at [Taiwan]), the national budget of the People’s Republic of China, and the fiscal strength of the People’s Republic of China in relation to internal instability in the People’s Republic of China and the likelihood of the externalization of problems arising from such internal instability.”

Key Findings

- China’s stated diplomacy promotes friendly relations with other countries, regional peace and stability, and development of complementary economic cooperation.¹ However, some of China’s international relationships, namely those with totalitarian, repressive governments, conflict with U.S. values.
- China’s regional activities in Latin America, Africa, and the Middle East and around East Asia are beginning to assume the character of a counterbalancing strategy vis-à-vis the United States. That is, China’s support for rogue regimes and anti-American governments and groups in vital regions serves an international purpose: to balance American power, create an alternative model of governance, and frustrate the ability of the international community to uphold its norms.
- China’s economic development policies can exacerbate instability in volatile regions. Beijing’s export-led growth has magnified trade imbalances, and complicated and inhibited local economic development strategies, in some instances undermining the ability of governments in those regions to prevent or respond to the rise of terrorist groups.
- China’s strategy to isolate Taiwan is manifest in its foreign policy actions around the world, including encouraging other nations to switch their recognition to the People’s Republic of China, and preventing Taiwan from participating in international organizations.

Overview

During the past decade, China has energetically expanded its outreach to the world. Dr. Ariel Cohen, Senior Research Fellow at The Heritage Foundation, testified to the Commission that “China has departed from its traditional isolationist philosophy and is seeking to project its influence abroad. China is, at present, a regional power with global aspirations, and if it continues on the path of economic growth and projection of influence, its aspirations may be realized.”²

China’s foreign policy goals include creating opportunities for continued domestic growth, isolating Taiwan internationally and encouraging other nations that recognize Taiwan to change their recognition, and ensuring continued rule by the Chinese Communist Party. China views peace and stability at home as necessary ingredients for economic growth.³ Economic growth, in turn, legitimizes and perpetuates Communist Party control. The result of this focus is China’s increased integration in world markets, the development of global economic interests, and the emergence of mechanisms designed to protect these interests. Deputy Assistant Secretary of State for East Asian and Pacific Affairs Thomas Christensen expressed to the Commission the hope that as China’s involvement around the globe increases, China will join the United States “in actions that will strengthen and support the global system that has provided peace, security, and prosperity to America, China, and the rest of the world.”⁴ Today, however, China’s international activities fall far short of this measure.

China’s Global Activities

Africa

China’s strategy for African relations is in great part driven by its need to obtain resources for its economy, strengthen its own influence and leadership in developing countries, and create a market for Chinese goods. Its presence in Africa is expanding, but China is still learning how to translate that presence into influence from which it can reliably benefit. Dr. Ernest Wilson, professor at the University of Maryland, told the Commission that “China is on a new glide path, and [a] new strategic direction, in experimenting with a variety of ways to use the tools of statecraft to open the doors to get privileged access to energy and resources in Africa and elsewhere.”⁵ China relies upon a combination of trade, military assistance, development assistance, corruption, and diplomacy to foster long-term partnerships with rulers and governments in African countries that possess resources it wants to obtain, especially petroleum.

African countries, namely Angola, Nigeria, the Republic of Congo, and Sudan, provide China with 20 to 30 percent of its current petroleum needs.⁶ One facet of China’s strategy is to diversify its sources of energy. For example, it will take risks in countries such as Sudan that are bypassed by Western oil companies. Dr. Wilson observed, “We should expect . . . that as Chinese companies strive to become more globally competitive they will engage in more aggressive sales and marketing in Africa . . . within but also beyond the natural resources sectors.”⁷

While in theory this trade could complement the activities in Africa of the United States and other Western nations, in practice it often contradicts multilateral efforts to improve democracy, human rights, and governmental accountability and transparency. China professes a policy of non-interference “with the internal political, institutional, and policy arrangements of its partners.”⁸ When President Hu Jintao visited Africa in April 2006, he “reiterated China’s policy of making business deals without any expectation that governments will improve democracy, respect human rights, or fight corruption.”⁹ However, in reality China facilitates situations that other countries will not accept. For example, in September 2006 in Zambia, after opposition candidate Michal Chilufya Sata threatened to break off diplomatic relations with China in the run-up to Zambia’s presidential elections, China actively supported the incumbent Levy Mwanawasa and offered new foreign aid programs to the country.¹⁰ Also, in 2005, China obstructed efforts by the United Nations to investigate President Robert Mugabe of Zimbabwe for his “clean-up campaign” that entailed police destroying slums and markets and depriving 700,000 Zimbabwean citizens of their homes or jobs.¹¹ In addition, China donated blue-glazed roof tiles for the President’s \$13 million presidential palace. It appears that Chinese contracts for providing hydroelectric generators to Zimbabwe correlate to these actions.¹² Such actions make the prospect of a relationship with China more appealing to the recipients than a relationship with the United States. Senator James Inhofe told the Commission that “the saying in Africa is, ‘the United States tells us what we need and China gives us what we want.’”¹³

China’s trade and investment activities are often linked with delivery of humanitarian and economic aid packages. According to Dr. Wilson, China is “getting creative” in places like Nigeria with agriculture, health care, water, and education/training projects.¹⁴ In addition to providing aid there, China has forgiven roughly \$1 billion in bilateral debt of African nations.¹⁵

China’s aid packages and projects typically focus on infrastructure development, such as constructing (or paying for the construction of) highways, railroads, and improved power supply systems; these efforts not only serve the interests of the recipient nation, but have a secondary purpose of supporting Chinese business investments in the area.¹⁶ Further, China’s foreign aid promotes China’s reputation as an international power and significant actor. China is seeking, and not infrequently obtains, diplomatic support as a result of its international activities—as illustrated in early August 2006 when Chad switched its diplomatic recognition from Taiwan to the People’s Republic of China.¹⁷

To further expand the appeal of China as an international partner, China has been willing to sell military equipment and arms (primarily small arms) to both African governments and, in some cases, rebel groups seeking to overthrow governments—for example, in Liberia.¹⁸ Between 2004 and 2005, Zimbabwe negotiated with China to acquire 12 jet fighters, six other jet aircraft, 100 military vehicles, and a radar intruder-detection system for President Mugabe’s home.¹⁹ Prior to Zimbabwe’s 2005 election, Chinese businesses provided radio wave jamming devices to be used against

anti-Mugabe radio stations.²⁰ China provided this support despite the fact that the United States and the European Union have sanctioned Zimbabwe for its abysmal human rights record.

Equally troubling is China's sales of small arms and equipment to the Sudanese government, and the role those arms play in the continuing conflict in the Darfur region. (See the case study on China's relationship with Sudan for more information—below.)

China's investments in Africa primarily support capital-intensive resource production industries including mining and oil refining, but typically do not foster the development of nascent African industries such as manufacturing. In essence, China is displacing industries considered a foundation for long-term economic growth. The South African Textiles Union estimates a loss of 60,000 jobs from a "tsunami" of imports from China,²¹ which has prompted South African leaders to negotiate with China in an attempt to reduce the negative effects on South Africa's labor force.²²

Moreover, China often imports Chinese workers to carry out its investment projects rather than hiring local African labor.²³ The failure to employ African workers means the nations where China's investment projects are being pursued will not benefit from transfer of skills, widely considered to be an important element of investing in developing countries. The Chinese approach means that there will be little if any increase in the personal income of the host nations' workers.

In sum, Dr. Wilson maintained, "To the degree that ... African industry is undercut, then the U.S. and other nations need to be concerned about the higher risk of economic stagnation, further political instability, humanitarian crises, and providing fertile ground for the growth of terrorist groups."²⁴

CASE STUDY: SUDAN

"There is in all of Africa no more destructive bilateral relationship than that between China and Sudan ... Beijing's relentless military, commercial, and diplomatic support of Khartoum's National Islamic Front regime has done much to ensure that Sudan remains controlled by a vicious cabal of unelected genocidaires,"²⁵ Dr. Eric Reeves, a professor at Smith College, told the Commission. The motivation behind this relationship is China's overwhelming desire to tap Sudan's oil reserves. Unlike many other nations, China is willing to work in such a risky and objectionable environment.

The China National Petroleum Company (CNPC) has been the primary actor in developing Sudanese oil production and its partnership with the government extends as far back as the mid-1990s. Because of the safety risks of operating in such an unstable area, China has hired militias to protect its oil operations and reserves and has cooperated with the Sudanese army to improve Sudan's infrastructure to extract and transport oil.²⁶ According to Dr. Reeves, highways and airstrips built jointly by the Chinese and Sudanese serve a dual purpose: they facilitate petroleum operations and also movement of Sudanese military forces around the country.²⁷

CASE STUDY: SUDAN—Continued

In addition, China continues to sell arms and military equipment to Khartoum, including “helicopter gunships, tanks, armored personnel carriers, heavy artillery, mortars, combat aircraft, and light weapons.”²⁸ U.N. investigators in the Darfur region have found that most of the small arms used in the conflict are of Chinese origin, stating “China has been, and continues to be, a major supplier of light weapons to the government of Sudan and many of the neighboring states.”²⁹ Moreover, an Amnesty International report on Chinese arms sales noted that China had shipped more than 200 military trucks to Sudan, which could be used to transport the Sudanese army and its allied militia, the Janjaweed.³⁰ China has also assisted Sudan in developing its own arms manufacturing capacity, including the facilities to build Chinese-model tanks.³¹

Of greatest international consequence is the impact of China’s non-interference policy on the genocide occurring in the Darfur region of Sudan. China has refused to allow progress on a U.N. Security Council resolution aimed at stopping the conflict in Darfur with the deployment of international peacekeeping forces or imposition of sanctions on the Khartoum government.³² Dr. Reeves stated in testimony, “The National Islamic Front [National People’s Congress], which controls all oil concession and operating contracts, counts on Chinese protection at the Security Council.” China abstained from the latest resolution considered in August 2006 to create a U.N. peacekeeping force and has played no role in encouraging the Sudanese government to accept U.N. peacekeepers.³³ According to Dr. Reeves, China has a “clear interest in sustained conflict in Sudan, at least at levels that do not threaten operations,”³⁴ and at levels that prevent Western countries from entering Sudan’s oil market.

Both Dr. Reeves and Deputy Assistant Secretary of State for East Asian and Pacific Affairs Thomas Christensen emphasized the importance of active U.S.-China cooperation on this issue and the necessity of public encouragement for China to act as a “responsible stakeholder” in this respect. Dr. Christensen said, “. . . China should participate with the United States in trying to create more transparent, accountable and ultimately stable governments in the areas where it gets its resources, both oil and otherwise.”³⁵ Essentially, the cessation of genocide in the Darfur region should be an objective in creating a responsible relationship between China and Sudan rather than focusing on maintaining energy access.

Latin America

In her testimony to the Commission, Dr. Cynthia Watson, professor at the National Defense University, characterized China’s behavior in Latin America as that of a state that perceives itself as an emerging power and “seeks to portray itself as a benevolent, welcome ‘newcomer.’”³⁶ China’s strategy is “calibrated and measured” to engage the region in ways and in places where the United

States is not involved,³⁷ and its activities are intended to raise China's visibility in the region.³⁸ Dr. William Ratliff, a Research Fellow at the Hoover Institution, explained in his testimony that many Latin American leaders have welcomed China's involvement in the region primarily because they believe the United States has not followed through on its promises for expanded relations and investment. He noted that President Hu Jintao of China spent more time in Latin America in November 2004 than President Bush has spent during his entire presidency.³⁹

Although China's trade with Latin America is comparatively smaller than its trade with other regions, China's imports from Latin America have increased by 600 percent in the past five years.⁴⁰ China focuses on accessing resources, including iron, soybeans, copper, and oil.⁴¹ Moreover, China's trade in Latin America appears designed to secure the entire supply chain in various key industrial sectors such as mining, a strategy termed vertical integration.⁴²

Among China's relationships with nations in the region, its relationship with Brazil arguably is the most important. Brazil's exports of non-genetically modified soybeans meet a major need in China. Supplying another and quite different facet of the relationship, China's and Brazil's space programs are working cooperatively and sharing information.⁴³ China also is developing a relationship with Venezuela because it wishes to tap that nation's oil resources. There is concern in some Latin America countries, however, that China is merely buying up resources and is not investing in the development of indigenous industries.⁴⁴

In addition to trade, China has participated in military exchanges and high-level visits with several Latin American nations. Latin American military officers have traveled to China for education and training at the People's Liberation Army National Defense University.⁴⁵ Dr. Watson concludes, however, that these and other high-level exchanges "appear to have limited effect and are certainly not a guarantee of weapons transfers or intelligence cooperation."⁴⁶

The diplomatic battle with Taiwan for formal recognition is an important feature of China's relations in Latin America, where Chinese officials continue to press countries to recognize China and to revoke their recognition of Taiwan.⁴⁷ Of the 24 nations that still recognize the Republic of China, 12 lie in Central and South America and the Caribbean. According to Dr. Watson, these states "... retain their ... recognition of Taiwan because Beijing has not yet offered them a better deal. While there are some trade reasons for Taiwan's ties with these states ... these ties are not likely to appear compelling to these states' governments over the long term if Beijing offers significant assistance and trade incentives."⁴⁸ For the most part, China's activities focused on recognition have been restrained, but it has taken limited steps to use trade and aid packages as incentives.⁴⁹

Dr. Watson concluded that China's activities in Latin America do not currently pose a threat to U.S. strategic interests.⁵⁰ Yet its engagement with leaders such as President Hugo Chavez of Venezuela who openly denounces the American government has the potential to undermine U.S. interests in the region. In particular,

China's support of Venezuela, Cuba, and Bolivia undermines the progress of democratic reforms in Latin America and harms efforts designed to improve transparency in Latin American governments and businesses. Dr. Watson advised the Commission that the United States could achieve greater security by improving bilateral relations within the region.⁵¹

CASE STUDY: VENEZUELA

China's relationship with Venezuela serves as an opportunity for China both to access Venezuela's oil resources and to establish a presence in the Western Hemisphere—notably in a location of substantial interest to the United States. In turn, for Venezuela, as Dr. Ratliff told the Commission, “[President Hugo] Chavez sees China as a country that is both critical ... of the United States and a major market for Venezuelan oil, and that market seems an ideal way to both reduce or end Venezuela's dependence on the United States and at the same time ... to drive Washington crazy.”⁵²

Although Venezuela cannot supply the amounts of petroleum to China that China obtains from other countries, this relationship allows China to diversify its energy supply. In August 2006, President Chavez traveled to Beijing, where China agreed to embark upon oil exploration and production projects valued at \$5 billion. In addition, President Chavez announced plans to multiply by more than a factor of six Venezuela's oil sales to China—from 155,000 barrels a day to 1 million barrels per day by 2012.⁵³ This increase has been accompanied by a decrease in sales to the United States. From January to June 2006, Venezuela's exports to the United States fell by 18 percent, and in July, Citgo Petroleum Corporation, a distribution and marketing subsidiary of Venezuela's state-owned oil company *Petróleos de Venezuela S.A.*, announced that it would reduce its U.S. network of gas stations by 14 percent.⁵⁴

China's inability to refine Venezuela's heavy oil and the costs of transporting this oil back to China create two economic obstacles. In response, China has pursued building a refinery as an alternative, but transportation costs are a significant impediment because Venezuela lacks a Pacific port and the Panama Canal cannot accommodate supertankers.⁵⁵ As a result, the time needed to ship the oil to China around either the Cape of Good Hope or Cape Horn is so great, and thus the cost becomes so high, that the exchange is unaffordable. Dr. Ratliff estimated in his testimony that transportation of Venezuelan oil to China could take up to five to ten times longer than it takes to ship the oil to the United States.⁵⁶ Moreover, in a time of crisis, China would have difficulties protecting the shipments.⁵⁷ Together these factors likely will prevent Venezuela from becoming a dominant supplier of oil to China.

Nonetheless, China has been investing in the relationship with Venezuela. It has supported Venezuela's military by selling mobile air defense systems to the armed forces. China also is

CASE STUDY: VENEZUELA—Continued

assisting with the design, production, and launching of Venezuela's VENESAT-1 telecommunications satellite; the China Great Wall Industry Corporation contracted to launch this satellite in 2008.⁵⁸ However, China has limited its interactions with Venezuela primarily to oil and related industries,⁵⁹ apparently as a hedge, because of the risks of Venezuelan political instability; its desire to avoid badly poisoning relations with the United States (with which China has far and away its most valuable Western Hemisphere relationship); and public image problems.⁶⁰

While China's activities and presence in Venezuela do not threaten Latin America or U.S. security interests yet, Chinese support of President Chavez and his anti-American rhetoric do not promote positive reform in Venezuela or elsewhere in the hemisphere. As is the case with so many of China's international relationships, its interactions with Venezuela cannot be characterized as the actions expected of a "responsible stakeholder" in the global community.

Middle East

China aspires to expand diplomatic influence in the Middle East, broaden its trade relationships there (primarily increasing markets for its exports), and gain access to a secure supply of petroleum. Dr. John Calabrese, Scholar-In-Residence at the Middle East Institute, noted in his testimony before the Commission that China's Middle Eastern diplomacy, largely based on commercial diplomacy, increasingly is more professionalized and institutionalized.⁶¹ Its relations are multifaceted and China employs a combination of high profile visits, long-term economic agreements, and cultural exchanges⁶² to solidify its position in the region as a strong economic partner. A number of Middle Eastern countries including Saudi Arabia, Iran, and Oman reciprocate China's desire to establish long-term partnerships in order to leverage China's presence in the region against the United States.⁶³

China's economic activities primarily focus on obtaining petroleum and opening the Middle Eastern market to exploration and production activities of Chinese oil companies.⁶⁴ Indeed, China's energy security is inextricably linked to the stability and prosperity of this region including the Persian Gulf. In 2005, approximately half its petroleum imports came from the Middle East.⁶⁵ It is projected that as much as 70 to 80 percent of China's future oil imports will have to come from the Middle East and North Africa.⁶⁶ China is well aware of this fact and is arranging its activities accordingly. As Dr. Calabrese told the Commission, "Chinese energy entities have shown a greater patience in overcoming the political and bureaucratic obstacles to doing business in the Middle East, as well as greater flexibility and higher tolerance for risk than many of their foreign competitors."⁶⁷ Saudi Arabia supplies China with the majority of its oil imports; Iran is China's second largest petroleum supplier.

Although petroleum considerations dominate China's relationships with the Middle East, those relationships do have other facets. Some analysts believe that China's approach is designed to prevent the spread of Islamic fundamentalism to China's predominantly Muslim Xinjiang province. The testimony of Dr. Ehsan Ahrari of the Strategic Paradigms Consultancy specifically mentioned that China's pursuit of a relationship with Iran intensified because of the willingness of both countries to ignore issues of domestic concern. For example, Iran did not interfere with the Uighur Muslim population in China, and China did not interfere with Iran's persecution of the communist-leaning Tudeh party in Iran.⁶⁸

In 2005, Chinese trade with the Middle East totaled approximately \$51.3 billion.⁶⁹ China is pursuing bilateral free trade agreements and sub-regional free trade agreements there, including an agreement with the Gulf Cooperation Council (GCC)⁷⁰ with which a third round of negotiations concluded in January 2006.⁷¹ Some of this trade, as well as other Chinese commercial and aid activity, is conceived as an incentive to facilitate China's access to the petroleum it so greatly desires. For example, Sinopec, one of China's national oil companies, has pledged to finance the modernization of an Iranian cement factory, as well as invest in electricity and telecommunications infrastructure.⁷² Dr. Calabrese noted that this and other similar pledges to Iran by China have not yet resulted in actual investment in that nation.⁷³ Dr. Calabrese noted that China's Middle Eastern partners have expressed frustration because investment projects have not been implemented as promised and that these projects are largely capital-intensive.⁷⁴ Middle Eastern oil producing countries need to create jobs for a growing youth population, and China's investments do not alleviate this problem. As in Africa and Latin America, Chinese consumer products have flooded Middle Eastern markets, especially in Iran, and have crowded out local producers, thus compounding labor problems.⁷⁵

China has a long history of selling arms, proliferating missiles, and providing militarily-useful technology to countries in the Middle East, including Saudi Arabia and Iran. Dr. Calabrese testified that not all these sales necessarily will destabilize the strategic balance in the region, but the transfer of dual-use items and technologies that enhance indigenous capabilities for missile proliferation could be more dangerous. He argued that "... the proliferation of missiles and missile-related technology—mainly to Iran—remains the most persistent and arguably the most dangerous aspect of Sino-Middle Eastern relations."⁷⁶

China's active diplomatic efforts to secure Middle Eastern energy supplies increase competition for American energy interests, and also weaken the impact of U.S. sanctions on Iran. However, the effects of China's activities in the Middle East on international peace and security go well beyond these two considerations. A major current example is that China has not supported U.S.-led efforts to implement U.N. sanctions against Iran in response to Iran's refusal to halt its nuclear weapons program and allow International Atomic Energy Agency (IAEA) inspections.

In addition, China's arms sales may affect regional stability through secondary proliferation. In July 2006, Hezbollah militants

launched anti-ship cruise missiles from the coast of Lebanon toward an Israeli anti-aircraft warfare ship. Reports identified the missile design by its electronic signature as a Chinese-designed C-802 “*Silkworm*” missile;⁷⁷ an estimated 150 such missiles were sold by China to Iran in the late 1990s.⁷⁸ China has not been accused of directly transferring missiles to Hezbollah, but this example illustrates that missile proliferation has consequences, especially when proliferating to countries that disregard international nonproliferation norms or that support terrorist organizations.

Central Asia

Internal and regional stability, access to petroleum, and competition with the United States for influence in the region constitute the focus of China’s diplomacy in Central Asia, and China approaches each issue with different strategic goals. Dr. Martha Brill Olcott, Senior Associate at the Carnegie Endowment for International Peace, stated in testimony before the Commission, “The Chinese leadership and its quasi-state business community have been very pragmatic in establishing and strengthening their relationship within Central Asia, making careful calculation of China’s short-, medium-, and long-term interests in the region.”⁷⁹

Internal security in part motivates China’s relationships with its Central Asian neighbors. In Xinjiang province, a very small element of China’s Muslim Uighur population has for some time expressed separatist sentiments. Observers generally do not believe these indicate an embrace of radical Islam but rather that they stem from a desire for sovereignty, land rights, and fair treatment by the Chinese government.⁸⁰ Given the similar ethnic and religious backgrounds of the populations of bordering Central Asian states, China fears the possibility that some of these states might decide to support Uighur aspirations for independence from China or greater autonomy. A major reason China engages the countries on its Western border—Kazakhstan, Kyrgyzstan, and Tajikistan—is to reduce the likelihood these countries will support the Uighur separatist movement⁸¹ and to obtain cooperation in ensuring border integrity and security.

China was instrumental in establishing the Shanghai Cooperation Organization (SCO), a regional agreement between China, Russia, Kazakhstan, Uzbekistan, Tajikistan, and Kyrgyzstan, as a vehicle for engaging Central Asia on issues of regional security and political and economic development. Four observer nations—Mongolia, India, Pakistan, and Iran—also attended its most recent meeting in June 2006. The SCO identifies “terrorism, separatism, and extremism” as principal security concerns. It also encourages cooperation on issues of border control and narcotics.⁸² Despite its appearance as a multilateral organization, Dr. Dru Gladney, professor at the University of Hawaii, argued to the Commission that the SCO “. . . has no other role than bringing the member countries together to discuss issues that are only and ever addressed bilaterally and resolved bilaterally.”⁸³ For example, although it was hailed as an example of SCO cooperation, the August 2005 Peace Mission military exercise involved only Russia and China.⁸⁴ The chief beneficiary of the SCO is China,⁸⁵ which uses it to promote its reputation as a leader in regional security affairs and a reliable

international partner. China also has used the SCO as an instrument for increasing its access to petroleum resources in the region.

China, indeed, has focused considerable attention on acquiring petroleum from Central Asia. In October 2005, one of China's national oil companies, China National Petroleum Corporation, purchased PetroKazakhstan, a Canadian-owned oil company in Kazakhstan, for approximately \$4.5 billion. In December 2005, China and Kazakhstan opened a 998-kilometer-long pipeline, expected to deliver 200,000 barrels per day to China by 2007.⁸⁶ China is also pursuing the development of a gas pipeline from Uzbekistan to connect with the Kazakhstan-China pipeline, and another pipeline linking it with Turkmenistan.⁸⁷

For the United States, China's involvement in Central Asia raises several questions. China and the United States have enunciated similar goals of opposing radical Islamic terrorism, and the two nations reportedly have cooperated on some anti-terror initiatives. Dr. Gladney, however, expressed doubts regarding China's sincerity in these efforts, primarily because the United States has not received cooperation from China in combating terrorism in Southeast Asia or in the Middle East, but also because he views Chinese anti-terror efforts as an excuse to expand control over Xinjiang Muslims in a political move serving the interests of China's government and the Chinese Communist Party that controls it.⁸⁸

Experts differ regarding China's perception and acceptance of the United States in Central Asia. Dr. Cohen argues that China began to feel strategically threatened by the United States' increased presence in that region following the September 11 attacks and subsequent invasion of Afghanistan, evidenced by China's support of public statements opposing U.S. democracy initiatives⁸⁹ and U.S. bases in Uzbekistan and Kyrgyzstan.⁹⁰ Chinese pressure coincided with other factors in Uzbekistan, and the U.S. base was closed.⁹¹ Also, in Kyrgyzstan, the rent for U.S. military bases was raised significantly.⁹² China is trying to use the SCO to reduce U.S. influence in the region and even contacted Kyrgyz officials to initiate discussions of placing Chinese military bases in Kyrgyzstan.⁹³ Conversely, Dr. Olcott contends that China has no immediate interest in pushing the United States out of Central Asia because China views the U.S. presence as a stabilizer in the region; however, she believes China would not endorse an extended U.S. presence in the region over the long term. With regard to China's statements against U.S. bases, she pointed out that these statements did not suggest a deadline for the departure of U.S. troops and that the statements originated from Uzbekistan, although both China and Russia supported them.⁹⁴

In Central Asia, China is encouraging regional economic integration, political dialogue, security cooperation, and development of Central Asia's petroleum market as a driver of economic growth. However, China has little interest in some of America's goals, such as promoting human rights, freedom of the press, and development of post-Soviet democratic political systems. Dr. Cohen told the Commission this sends the wrong message to Central Asian leaders.⁹⁵ He also indicated that China's actions may be an effort to resurrect or create a modern form of the tributary system that ex-

isted during the era of Imperial China.⁹⁶ China's relationships with Central Asian states do not support governmental and economic reforms toward democracy, human rights, and free market economies.

Northeast and Southeast Asia

China is expanding trade with the nations of Northeast and Southeast Asia. As is the case with its relationships with Central Asia, one of its primary objectives in its relationships with Northeast and Southeast Asian states is to ensure stability and security, often at the expense of values the United States thinks are important, such as democracy and peace. China desires not to dissipate its attention and resources in contending with conflict or disorder at or near its borders. Rear Admiral Michael McDevitt (USN-Ret.), Director of the Center for Strategic Studies at the Center for Naval Analyses, told the Commission, "There is no question that China is the dominant economic and military power on the continent of Asia. Despite being dominant in terms of power, Beijing's relations with its neighbors are dictated by its grand strategic objective of preserving peace and stability in its "near abroad" so that economic development can proceed."⁹⁷ Additional objectives include gaining economic advantage, reassuring Asian countries of China's peaceful rise, isolating Taiwan, and increasing international influence.⁹⁸

RADM McDevitt characterized China's relations with Northeast Asian countries as promising, with the exception of Japan. China's diplomacy toward Japan has been marked by "latent tensions" concerning unresolved issues of history. More recently, China's government focused on former Japanese Prime Minister Junichiro Koizumi's visits to the Yasukuni shrine to highlight those historical issues.⁹⁹ In addition, both countries currently compete for energy supplies in the East China Sea and, fueled by growing nationalism, have not resolved territorial disputes.¹⁰⁰ With new Prime Minister Shinzo Abe's visit to China in October 2006, the two nations reportedly are trying to ease existing tensions and reestablish bilateral dialogue.¹⁰¹

China's bilateral relations with the Republic of Korea, or South Korea, are generally positive. China and South Korea share interests in stability on the Korean peninsula.¹⁰² China's soft power and cultural attraction have increased; Chinese has replaced English as the most popular language studied by liberal arts majors in South Korea.¹⁰³

Despite China's stated peaceful objectives, Asian nations have expressed concerns about China's intentions in the region.¹⁰⁴ A number of Asian countries are hedging against the dangers they perceive in a more powerful China by strengthening bilateral relationships, including with the United States, and multilateral relationships to "preserve their independence and freedom of action."¹⁰⁵ Japan, South Korea, Thailand, and Taiwan have maintained close relationships with the United States and each has involved itself in a number of economic, security-related, and political multilateral organizations.

The nations of Southeast Asia have achieved a notable degree of cooperation through the Association of Southeast Asian Nations (ASEAN). In his testimony to the Commission, Dr. Karl D. Jack-

son, professor at the School for Advanced International Studies at Johns Hopkins University, identified three specific emphases of the ASEAN organization related to the member nations' desire to hedge against China's rise: expanding its membership to include a total of ten nations; signing an ASEAN-China Treaty of Amity and Concord; and insisting that the United States remain engaged in the region.¹⁰⁶

China's commercial activities are the most evident conduit for China's influence in Asia, and they have benefited China's reputation.¹⁰⁷ In Southeast Asia, however, the United States remains the most important economic partner, primarily for two reasons. Southeast Asian economies have been affected by China's currency peg, making Southeast Asian exports less competitive with Chinese exports and shifting foreign direct investment toward China.¹⁰⁸ In addition, Chinese investment in the region remains small, so manufacturers are receiving little help in contending with the competition of low-priced goods from China's expanding processing industries.¹⁰⁹

Dr. Robert Sutter, professor at the Walsh School for Foreign Service at Georgetown University, argues that China's growth and diplomatic expansion reinforce the desire for U.S. leadership in the region as a "security guarantor and vital economic partner."¹¹⁰ His view was echoed by Rear Admiral McDevitt: Asian governments seek interaction with the United States to increase their confidence and comfort in engaging with China.¹¹¹ Without the U.S. presence, Asian countries would be more concerned about China.

The consequences of more aggressive attitudes toward China by other Asian nations could fuel conflict, especially in the case of Japan. RADM McDevitt argued that the United States should promote trilateral cooperation among the United States, Japan, and China and to encourage both Japan and China to take on the responsibilities and role of a "responsible stakeholder" regionally and globally. Increased stability in the Japan-China relationship could lower regional concerns about China's military modernization, and Dr. Sutter asserts that U.S. involvement toward this end could provide both countries with a way to adjust their antagonistic policies and open the door to a more positive diplomacy.¹¹²

CASE STUDY: BURMA

China's relations with Burma bolster the capability of the military junta to rule the country by keeping the Burmese economy afloat in the face of international sanctions. China is the largest investor in Burma, and provides low-interest loans to the Burmese government—most recently a June 2006 pledge of a \$200 million loan to five unspecified government ministries. China also supplies 90 percent of Burma's military's armaments and has granted \$1.6 billion in military assistance and modernization funding.¹¹³ In return, China will receive access to Burma's natural resources—including timber, oil, and natural gas. Moreover, this relationship with Burma potentially could enhance China's power projection capability by extending its presence into the Bay of Bengal and the Andaman Sea, two areas vital to the transportation of China's oil imports from the Persian Gulf.¹¹⁴

Although they will not be able to compete with the volume of natural gas China imports from Iran, Burma's natural gas reserves are of importance to China's energy security because this natural gas can be transported overland by a proposed pipeline directly linking the two countries. This has prompted China to invest heavily in Burma's natural gas sector; in November 2005, PetroChina signed a 30-year contract with Burma for 6.5 trillion cubic feet of natural gas, and in February 2006 China loaned Burma \$85 million to purchase two new oil rigs.¹¹⁵ Jared Genser, a fellow for the National Endowment for Democracy and lead author of the Havel-Tutu Report calling for U.N. action in Burma, stated in testimony that he feared PetroChina's activities would benefit from Burmese forced labor and would be indirectly responsible for human rights violations.¹¹⁶

Despite the positive economic relations between China and Burma, this relationship has had negative consequences both domestically and internationally for China. Burma's trade in opium, heroin, and methamphetamine is responsible for increased drug addiction in southern China, and a significant number of HIV/AIDS cases can be traced to China's provinces that border Burma.¹¹⁷ These negative impacts have induced public statements from the Chinese government against Burma's illegal drug trade and its inability or unwillingness to control the situation. Internationally, China's support for Burma has drawn criticism. In December 2005 and May 2006, the U.N. Security Council held private briefings on the situation in Burma, to which China agreed in order to prevent a public discussion from reaching the formal agenda.¹¹⁸ Most recently, in September 2006 the U.N. Security Council placed Burma on its formal agenda, which will allow it to examine the situation there. China opposed this decision.¹¹⁹

Hong Kong and Taiwan

Both Hong Kong and Taiwan, as ingredients in the U.S.-China relationship, are of great importance. Each in its own way acts as a bellwether for determining whether China's rise will collide with fundamental U.S. interests or whether it will avoid conflict. Hong Kong and Taiwan, also, offer arguably the easiest and most convenient opportunities for China to demonstrate that it is ready, willing, and able to accept the role of responsible stakeholder in the community of nations and use its growing power, economic clout, and influence for global benefit in a "win-win" manner, rather than in a way that benefits China at the expense of other nations.

Hong Kong

Hong Kong's "one country—two systems" structure was originally codified in the agreement between China and the United Kingdom that resulted in the return of the former British territory to Chinese control in 1997. The conditions of the return purported to guarantee a continuation of the greater degree of autonomy, democracy, human rights, and a free market economic system that existed in Hong Kong than exist in China—and to offer the promise of further democratization. It is of great significance to the United States whether China honors its commitments.

Because of the importance of the status of Hong Kong, each time in the past several years that a delegation of Commissioners has visited China, a stop in Hong Kong has been included to enable Commissioners to talk with Hong Kong citizens and officials, as well as with American diplomats and businessmen, to assess whether the commitments are being honored, and whether Hong Kong is progressing, retreating, or just maintaining the status quo in these important respects.

Based on the observations of the Commissioners who visited Hong Kong in June 2006, it appears that many of the political and economic guarantees assured in the Sino-British agreement of 1997 have been retained, such as preservation of the legal system and economic autonomy. However, there are areas of concern.

Hong Kong's citizens are guaranteed a free press—which performs a crucial function in any democratic state as a "watchdog" of the political process and government on behalf of the people. Unfortunately, whether or not the effort is orchestrated by Beijing, the independent and outspoken news media in Hong Kong have been disappearing. The great majority of news organizations now belong to larger business organizations that seek a cooperative relationship with the Chinese government in order to enable and facilitate their commercial activities. They seek to ensure their media subsidiaries do not antagonize the government. There is widespread agreement that only one widely available newspaper remains independent and vocal in its assessment of the Hong Kong government's and Chinese government's actions and intentions, and there are fears that its owner may be unable to resist delivering it to the same fate as all the others. Moreover, China's arrest of journalists has prompted fears even among employees of foreign newspapers, especially as China's treatment of the arrested journalists and denial of basic legal rights during trial indicate political motivations for the government's actions.¹²⁰ If this vital means of criticism and

introspection is lost to Hong Kong, there are questions about whether or not Hong Kong's democratic features can be preserved and expanded.

The Hong Kong Basic Law suggests that Hong Kong will move toward further democratization of its electoral process—in the form of “universal suffrage”—for its legislative body, the Legislative Council, and its Chief Executive.¹²¹ The current process has a strong “constituency-based” element. Many Hong Kong citizens—and the United States and other democratic nations—had hoped for early progress in this direction. However, late in 2005 Hong Kong Chief Executive Donald Tsang, recently appointed by the Chinese government, announced that movement toward universal suffrage would not occur in the immediate future.¹²² In his October 2006 annual policy address, he indicated that progress on this issue again would be delayed.¹²³

The Commission reiterates its belief that the Hong Kong system is a crucial one, and that it is very important for the United States and other democracies to maintain a close watch on developments there, and to sound the alarm should there be any significant erosion of those democratic, human rights, and economic differences that set it apart from China. To this end, the Commission expects to continue to visit Hong Kong as it visits mainland China to update its knowledge and understanding of occurrences there so that it can convey those to the Congress for its evaluation and action.

Taiwan

U.S. support for Taiwan has grown as the island has democratized, and as it has developed a free market economy that offers an important economic partnership to the United States and other trading nations. This support is underpinned by the Taiwan Relations Act and by other statutes and Executive Orders. Despite the fact that the United States switched its formal recognition from Taiwan to China during the late 1970s, the United States maintains close ties to Taiwan. It has made important defensive weapons systems available for Taiwan to purchase in order to deter Chinese aggression. And it has encouraged development of bilateral trade and commercial relationships. The Commission supports Taiwan's democratic system; it believes it is in the U.S. interest for Taiwan's democracy and free market system to flourish and for both sides of the Taiwan Strait to work out their differences in a peaceful manner free of threats and coercion.

A Commission delegation visited Taipei in the summer of 2006 for discussions with Taiwan government officials, policy analysts, academics, and business people, and with American diplomats and business people concerning Taiwan's relationship with the United States, Taiwan's relationship with China, and Taiwan's internal political situation.

Among the topics the delegation discussed was the increasingly complicated relationship that has developed between Taiwan and China, largely as a result of the heavy investments Taiwan businesses have made in China's economy, and establishment by many of those businesses of manufacturing plants and other activities and facilities there. Taiwan is the largest source of foreign investment in China today. Recognizing this situation poses some signifi-

cant risks to Taiwan, government officials told the Commission delegation that mechanisms are in place to limit investments in the mainland, but they acknowledge that many Taiwan businesses evade those restrictions by establishing companies in economically free-wheeling locations such as the Cayman Islands and Bermuda and using those companies as conduits for their investments.

Complicating this situation are China's persistent efforts to economically, militarily, and diplomatically isolate Taiwan and prevent it from integrating in the regional economy and from playing a role in the international community.¹²⁴ A number of those to whom the Commission delegation spoke, both in and outside government, during its visit to Taipei emphasized this concern. In August, Dr. Sutter testified to the Commission that Chinese officials have been effective in these efforts to isolate Taiwan, especially by preventing Taiwan's entrance into regional economic organizations.¹²⁵ Moreover, he stated, "Over time, Chinese pressure, backed by China's increasing importance to Southeast Asian countries, has made visits of Taiwan officials [to those Southeast Asian nations] at the ministerial level difficult while visits of top-level Taiwan officials are very rare."¹²⁶

Taiwan is particularly concerned about U.S. free-trade agreements with other Asian nations, notably including South Korea, fearing that these may result, even if inadvertently, in a deflection of some trade activity from Taiwan to the nations with which the special arrangements exist. Government officials, policy analysts, and business people all expressed a strong hope to the Commission's delegation that the United States would agree to vigorous negotiations intended to produce a Taiwan-United States free-trade agreement at the earliest possible date, and assured the delegation that Taiwan is prepared to make agricultural and other trade concessions that will be necessary in order to produce an agreement. Taiwan leaders believe that achieving a free-trade agreement with the United States is an economic necessity, but that it is, in fact, even more than that: it is a strategic necessity without which Taiwan fears its ability to survive and prosper in the Western Pacific/East Asian region, and the world at large, will begin to erode.

Another consistent topic of discussion with the Commission delegation to Taiwan was the concerted efforts by the Chinese to "divide and conquer" the Taiwan political system by pitting one Taiwan political party against another. Political struggles in Taiwan over the issue of independence and the relationship with the mainland, combined with rising domestic political tensions and allegations of corruption, have distracted Taiwan's democracy from further development and from making policy choices important for its own security—including, for example, the long-stalled purchase of items in the U.S.-approved defensive arms package.

[NOTE: Issues related to the defense of Taiwan and the military balance between China and Taiwan are addressed in Section 3—"The Military Balance Across the Taiwan Strait"—of Chapter 3.]

SECTION 2: CHINA'S PROLIFERATION AND INVOLVEMENT IN NORTH KOREA'S AND IRAN'S NUCLEARIZATION ACTIVITIES

The Commission shall investigate and report on “PROLIFERATION—The role of the People’s Republic of China in the proliferation of weapons of mass destruction and other weapons (including dual use technologies), including actions the United States might take to encourage the People’s Republic of China to cease such practices.”

Key Findings

- Chinese companies and government organizations continue to proliferate weapons, weapons components, and weapons technology. Some of these transfers violate China’s international nonproliferation agreements, harm regional security in East Asia and the Middle East, and are a measure of China’s failure to meet the threshold test of international responsibility in the area of nonproliferation. Given strong U.S. interests in both regions, Chinese proliferation threatens U.S. security and potentially could place at risk U.S. troops operating in those regions.
- China possesses the unique ability to influence North Korea’s actions, partly because of the great extent to which North Korea depends on it for consistent supplies of food and fuel. Notwithstanding its commendable efforts to persuade North Korea to remain involved in the Six-Party Talks seeking to obtain North Korean agreement to end its nuclear program, China has refused to use its leverage effectively to pressure North Korea to cease its nuclear and missile development activities and, in particular, not to conduct the nuclear test it conducted in October.
- Chinese companies and government organizations continue to assist Iran’s missile development program, and have aided Iran’s nuclear program. China also has refused to cooperate in the efforts by a number of nations to persuade or force Iran to halt its military nuclear program and instead has offered political and moral support for Iran and obstructionism in the United Nations.
- China’s continued frustration of nonproliferation efforts may precipitate additional nuclear proliferation, including nuclear weapons development and transfer of nuclear weapons to non-nuclear nations and terrorists, proliferation of other weapons of mass destruction, and conventional arms races.

China’s Proliferation Record

In testimony before the Commission, Assistant Secretary of State for Compliance, Verification, and Implementation Paula DeSutter acknowledged that the U.S. government has repeatedly engaged the Chinese government at its highest levels “to reinforce our message that the proliferation of WMD [weapons of mass destruction] and missile technology is a threat to our mutual security.”¹²⁷ Despite this effort and additional dialogues on missile modernization and nuclear policy,¹²⁸ the United States “remain[s] disappointed in the continuing proliferant behavior of certain Chinese entities, and ...

about the Chinese government's commitment towards its non-proliferation obligations.”¹²⁹

The following chart lists current multilateral nonproliferation treaties and regimes and describes China's status and level of participation with respect to them:

International Nonproliferation Agreements and China's Participation

Nonproliferation Regime	Description	China's Response
Biological Weapons Convention (BWC)	Outlaws the production, development, storage, and use of biological weapons	China acceded to the BWC in 1984 ¹³⁰
Chemical Weapons Convention (CWC)	Outlaws the production, storage, and use of chemical weapons	China signed the CWC in 1993. In 1997, China ratified the convention ¹³¹
Nuclear Nonproliferation Treaty (NPT)	The five original nuclear states (France, China, USSR (now Russia), United Kingdom, and United States) agree not to use nuclear weapons against non-nuclear states except in response to a nuclear attack, and to prevent the transfer of nuclear weapons to non-nuclear states; and affirm the right of states that do not possess nuclear weapons to use peaceful nuclear technology	China acceded to the NPT in March 1992 ¹³²
Zangger Committee	Maintains a list of equipment that may be exported only to facilities that have nuclear safeguards in place, and fosters coordination among states for controlling the export of nuclear materials	China joined the Zangger Committee in 1997 ¹³³
Nuclear Suppliers Group (NSG)	Controls the export of materials that may be used for nuclear weapons development	China joined in May 2004 ¹³⁴
Comprehensive Test Ban Treaty (CTBT)	Each party agrees to prohibit "... any nuclear weapon test explosion or any other nuclear explosion, and to prohibit and prevent any such nuclear explosion at any place under its jurisdiction or control," and to "... refrain from causing, encouraging, or in any way participating in the carrying out of any nuclear weapon test explosion or any other nuclear explosion." ¹³⁵	China signed in September 1996, but has not ratified the treaty. (The United States is a signatory, but also has not ratified the treaty)

International Nonproliferation Agreements and China's Participation—Continued

Nonproliferation Regime	Description	China's Response
Missile Technology Control Regime (MCTR)	A "set of voluntary guidelines that seeks to control the transfer of ballistic and cruise missiles that are inherently capable of delivering at least a 500 kg (1,100 lb) payload a distance of at least 300 km (186 mi), called "Category I" or "MCTR-class" missiles" ¹³⁶	China is not a member. However, it has made qualified commitments to "abide by various missile nonproliferation commitments." ¹³⁷ Under these commitments, China exempted certain missiles and grandfathered early transfers. Its most recent commitment in 2000 stated that it would not assist "in any way, any country in the development of ballistic missiles that can be used to deliver nuclear weapons (i.e. missiles capable of delivering a payload of at least 500 kilograms to a distance of at least 300 kilometers)." ¹³⁸ China has not committed to restrictions pertaining to other missiles. ¹³⁹
Proliferation Security Initiative (PSI)	An effort led by President Bush to prohibit and prevent the transfer of banned weapons and technology applicable to nuclear, chemical, and biological weapons	China has not joined, voicing concerns about the legality of the PSI
International Code of Conduct Against Ballistic Missile Proliferation	Intended to curb the proliferation of ballistic missiles and to support the implementation of the MCTR	China has not joined

China has not even fulfilled the nonproliferation obligations it has agreed to accept.¹⁴⁰ Evidence of recurring transfers of militarily-sensitive materials, products, and technologies by Chinese companies and government organizations suggests that some of these organizations are serial proliferators and have no fear of government controls or punishments.¹⁴¹ As Assistant Secretary of Defense for International Security Affairs Peter Rodman noted in his September testimony, these organizations, including state-owned enterprises (SOEs), continue to supply items and technology useful for developing WMD and delivery systems.¹⁴² Some of these missile technologies can be used in a variety of missile programs.¹⁴³ Additionally, the United States remains concerned that China is currently conducting biological and chemical weapons research in violation of its obligations under the Biological Weapons Convention and the Chemical Weapons Convention;¹⁴⁴ that it continues to expand its missile modernization program;¹⁴⁵ and that proliferating companies and government organizations in China could transfer the products of these efforts to North Korea, Iran, and other nations or to terrorist organizations engaged in various proliferation activities.

The United States has attempted to persuade China to step up its enforcement of its domestic nonproliferation laws and regulations, and to comply with its international nonproliferation commit-

ments.¹⁴⁶ Also, the United States has worked to deter Chinese companies and government organizations from proliferating by altering the incentive structure,¹⁴⁷ increasing the political and economic costs of proliferation. Sanctions are the primary vehicle for this effort. Below is a chart listing sanctions imposed on Chinese companies and organizations since the issuance of this Commission's 2005 Annual Report:

**List of Sanctions Imposed on Chinese Entities Since
November 2005**

Date	Entity/Person	Controlling Statute
December 2005	<ul style="list-style-type: none"> • China Aero-Technology Import/Export Corp. (CATIC) • North China Industries Corporation (NORINCO) • LIMMT Metallurgy and Minerals Company Ltd. • Ouinion (Asia) International Economic and Technical Cooperation Ltd. • Zibo Chemet Equipment Company 	Iran Nonproliferation Act: regarding missile and chemical weapons proliferation
June 2006	<ul style="list-style-type: none"> • Beijing Alite Technologies Company Ltd. (ALCO) • LIMMT Economic and Trade Company Ltd. • China Great Wall Industry Corporation (CGWIC) • China Precision Machinery Import-Export Corp. (CPMIEC) • G.W. Aerospace (a U.S. office of CGWIC) 	Executive Order 13382: regarding missile proliferation
August 2006	<ul style="list-style-type: none"> • Great Wall Airlines Company Ltd. 	Executive Order 13382: regarding missile proliferation and dual-use components.

In June 2006, as the chart indicates, the United States imposed sanctions on four Chinese companies plus the U.S. subsidiary of one of them, under Executive Order 13382¹⁴⁸ because the U.S. government determined that they provided, or attempted to provide, support for Iran's Aerospace Industries Organization (AIO), a key actor in developing Iran's missile program.¹⁴⁹ All of the firms subjected to sanctions in this round had been sanctioned previously under other U.S. laws.¹⁵⁰ Assistant Secretary Rodman's testimony indicated that one of these companies, China Precision Machinery Import-Export Corporation (CPMIEC), had transferred items controlled under the Missile Technology Control Regime (MTCR) and thus in violation of China's obligations and commitments to prevent missile transfers and technology.¹⁵¹ In August 2006, the Great Wall Airlines Company was designated as a proliferator; its parent company, China Great Wall Industry Corporation (CGWIC), was sanctioned in June. Great Wall Airlines had to suspend its operations after the designation because the Boeing Company, an American corporation, thereafter was prohibited from supplying to the firm technical assistance, parts, and aeronautical charts for pilots.¹⁵²

Although China has domestic legal mechanisms in place to support nonproliferation efforts, particularly an export control system, to date Chinese action against proliferating companies and government organizations has been “uneven” and “irregular.”¹⁵³ Thus, the question is whether China’s failure to cease proliferation results from the government’s inability to control actors within the country or from China’s unwillingness to enforce its own laws. It appears that China’s proliferation activities are facilitated by a “general willingness to transfer a wide variety of technologies to customers around the world, including to states of concern, not only Iran and North Korea, but [also] Sudan, Burma, Zimbabwe, Cuba, and Venezuela.”¹⁵⁴ These transfers may alter the balance of power in the regions in which these countries are located, or may be retransferred to non-state actors including terrorists. Assistant Secretary Rodman stated that Chinese leaders now acknowledge the danger of secondary proliferation and the potential for nuclear terrorism,¹⁵⁵ but China’s weapons transfers often occur in concert with Chinese attempts to improve economic and trade relations with certain countries, especially those with significant natural resources. In this respect, China permits its economic objectives and their political implications to trump its nonproliferation commitments.

China’s transfers of militarily-sensitive items, whether conventional arms or related to weapons of mass destruction, may spark regional instability and also harm U.S.-China bilateral relations¹⁵⁶ as the United States responds to proliferation threats around the globe. The propensity of China’s proliferation partners to retransfer items received from China could produce grave repercussions for China—for example, if it were established that a North Korean nuclear bomb traveled through China (as a result of lax customs controls and poor inspection policies) to a rogue nation or terrorist group¹⁵⁷ that detonated it on U.S. territory or that of a U.S. ally, or used the bomb to help it acquire its own nuclear capability.

Also among the consequences of North Korea’s nuclear capability and the possibility Iran also will acquire such capability is the possibility other nations in Asia and the Middle East will initiate efforts to obtain nuclear capability.

This section further examines China’s proliferation record in the context of its proliferation to North Korea and Iran. A more detailed understanding of the political and economic motivations behind the proliferation of weapons and technology can be gained from these two cases, as well as a deeper appreciation for the secondary consequences of such actions. Moreover, these cases will examine the extent to which China can be considered a responsible stakeholder with respect to nonproliferation.

China’s Proliferation to North Korea and Its Role in North Korea’s Nuclear Weapons Development

China has a history of assisting the North Korean regime in the development of weapons programs. As early as 1998, the United States publicly confirmed reports of China’s assistance to North Korea in developing missile capabilities and in supporting the transfer of missile components.¹⁵⁸ As recently as 2004, the Director of Central Intelligence reported that North Korea acquired missile-related assistance from China.¹⁵⁹

China has contributed at least indirectly to North Korea's nuclear weapons program. China was the "principal supplier" to Pakistan's nuclear weapons program, and several links have been identified between North Korea and Pakistan and its nuclear laboratories headed by A.Q. Khan.¹⁶⁰ *The Washington Post* reported in February 2004 that A.Q. Khan sold a nuclear bomb design to Libya that he obtained from China, and this raises concerns that Khan may have sold other Chinese-designed nuclear weapons technology to North Korea.¹⁶¹ In 2003, the Central Intelligence Agency estimated "that North Korea has produced one or two simple fission-type nuclear weapons and has validated the designs without conducting yield-producing nuclear tests."¹⁶² In October 2006, *The Washington Post* cited U.S. intelligence officials who estimated that North Korea might have as many as six nuclear devices, or more.¹⁶³

Since 1994, China has facilitated negotiations involving North Korea, the United States, and other nations concerning North Korea's nuclear program.¹⁶⁴ Princeton University Professor Aaron Friedberg testified that in 2002 China engaged more actively in this process due to the concern that the United States might use force against North Korea.¹⁶⁵ Between August 2003 and September 2005, China hosted four rounds of the Six-Party Talks that have included China, North Korea, South Korea, Japan, Russia, and the United States. During the last round, the parties agreed to a Joint Statement of Principles in which "[t]he [Democratic People's Republic of Korea—or North Korea] committed to abandoning all nuclear weapons and existing nuclear programs and returning, at an early date, to the Treaty on the Non-Proliferation of Nuclear Weapons and International Atomic Energy Agency (IAEA) safeguards."¹⁶⁶ Although the statement did not discuss a concrete timeline for dismantling North Korea's nuclear program and any weapons it had produced, it was widely recognized as a positive step forward in the negotiations, and China was credited with brokering the agreement.¹⁶⁷

Unfortunately, since that last round in September 2005, no progress has occurred with the Six-Party process. The Joint Statement had announced another round of talks to occur in November 2005, but North Korea boycotted the meeting. The reason North Korea gave was that it was protesting the United States freezing North Korean accounts worth \$24 million at the Banco Delta Asia in Macau.¹⁶⁸ The United States froze those accounts after obtaining evidence the bank was involved in laundering money from North Korean illicit trading activities and placing into circulation counterfeit U.S. currency made by North Korea.¹⁶⁹ North Korea refused to resume talks until the United States terminated its action against Banco Delta Asia and the stalemate has continued to the present.

In July 2006, North Korea test-fired seven missiles, including the long-range Taepodong-2 missile with a range estimated to reach the continental United States. After these tests, China and Russia urged the United States and Japan to respond cautiously and, in particular, not to rush to seek sanctions. North Korea threatened "all-out countermeasures" if the U.N. Security Council imposed sanctions.¹⁷⁰ On July 15, 2006, the Security Council passed Resolution 1695 condemning the missile launches; demanding that North Korea suspend all activities related to its ballistic missile program;

and urging North Korea to return to the Six-Party Talks without preconditions.¹⁷¹ The resolution imposed what are considered targeted, punitive sanctions against North Korea, requiring U.N. member states, consistent with their own laws, “to exercise vigilance and prevent missile and missile-related items, materials, goods and technology being transferred to DPRK’s missile or WMD programmes,” and to prevent “the procurement of missiles or missile-related items, materials, goods and technology from the DPRK, and the transfer of any financial resources in relation to DPRK’s missile or WMD programmes.”¹⁷² China voted for the resolution, but only after language imposing the sanctions under the authority of the U.N. Charter¹⁷³—which can be used to require U.N. member nations to institute sanctions and take other steps without regard to their national laws—was deleted from the text.¹⁷⁴

In early October 2006, Pyongyang announced that it had conducted a nuclear test, which was later confirmed by the United States. China has strongly criticized North Korea for conducting the test, and announced that it will support “carefully targeted” sanctions in the United Nations. However, as the Security Council crafted a resolution, China objected to sanction measures proposed by the United States and Japan.¹⁷⁵ After a series of negotiations, Beijing agreed to Resolution 1718, which then was adopted by the Security Council. Among other things, the resolution, under Chapter VII authority (removing discretion for member nations under their own laws), requires U.N. member nations to do the following:

“prevent the direct or indirect supply, sale or transfer to the DPRK, through their territories or by their nationals, or using their flag vessels or aircraft, and whether or not originating in their territories, of:

- (i) Any battle tanks, armoured combat vehicles, large caliber artillery systems, combat aircraft, attack helicopters, warships, missiles or missile systems as defined for the purpose of the United Nations Register on Conventional Arms, or related material including spare parts, or items as determined by the Security Council or the Committee established by paragraph 12 below (the Committee);*
- (ii) All items, materials, equipment, goods and technology as set out in the lists in documents S/2006/814 and S/2006/815 ... as well as other items, materials, equipment, goods and technology, determined by the Security Council or the Committee, which could contribute to DPRK’s nuclear-related, ballistic missile-related or other weapons of mass destruction-related programmes;*
- (iii) Luxury goods.”*

In addition, all Member States shall “freeze immediately the funds, other financial assets and economic resources which are on their territories at the date of the adoption of this resolution or at any time thereafter, that are owned or controlled, directly or indirectly, by the persons or entities designated by the Committee or by the Security Council as being engaged in or providing support for, including through other illicit means, DPRK’s nuclear-related, other

*weapons of mass destruction-related and ballistic missile-related programs—and ensure that any funds, financial assets or economic resources are prevented from being made available by their nationals or by any persons or entities within their territories ...”; and to prevent “illicit trafficking in nuclear, chemical, or biological weapons, their means of delivery and related materials” by taking “cooperative action including through inspection of cargo to and from the DPRK as necessary.”*¹⁷⁶

Despite China’s vote for the resolution (that had been somewhat diluted at its insistence), the United States has concerns about China’s willingness to fully support it and implement all its provisions, particularly the provision for inspection of cargo moving to and from North Korea. China has indicated it will not be involved in interdicting North Korean ships on the open sea, but did agree to inspect cargo passing through its territory.¹⁷⁷ The U.S. Department of State has acknowledged that China has begun inspecting trucks traveling across China’s border to North Korea.¹⁷⁸

In his testimony to the Commission, Deputy Assistant Secretary of State for East Asian and Pacific Affairs Thomas Christensen stated that China’s cooperation with the United States, including China’s hosting of the Six-Party Talks, its brokering of the September 2005 Joint Statements, and its vote in support of Resolution 1695, are positive examples of China becoming a responsible stakeholder.¹⁷⁹ These actions produced a “qualitative and quantitative improvement” in U.S.-China dialogue and collaboration related to North Korea.¹⁸⁰ Yet, Christensen and others agree that China can and should do much more,¹⁸¹ especially as the nuclear crisis continues to unfold. For example, China could suspend its economic aid to North Korea, restrict trade, limit cross-border interactions, and stop illicit activities by North Korea that are conducted through or from China—not to mention it could threaten to cease relations with North Korea.¹⁸²

Of key importance to resolving the North Korean nuclear crisis is an understanding of the different objectives and strategies of each party involved. This analysis will only address the United States and China. In the view of Commission witness Dr. Friedberg, within the Six-Party Talks, the United States has focused on the process of the talks and on China’s participation in the process.¹⁸³ Sitting down at the negotiating table was perceived as an accomplishment. On the other hand, China deflected U.S. attention from the question of whether the process produced results.¹⁸⁴

China’s approach to the Six-Party Talks reflects concerns about the effects of economic and political instability on its border if the North Korean regime falls. Dr. Friedberg testified that since the United States confronted North Korea in October 2002 about its nuclearization activities, China has refused to exert economic pressure on North Korea; instead, it has actually increased its assistance and trade.¹⁸⁵ Beijing has encouraged North Korea to adopt economic reforms modeled on China’s policy of liberalization, in an attempt to integrate North Korea into the regional economy and to promote growth.¹⁸⁶ Thus, as noted by Dr. David Asher, Adjunct Scholar at the Institute for Defense Analyses and former senior ad-

visor to the U.S. State Department for East Asian affairs, "... China apparently believes that it can live with a nuclear-armed North Korea as long as the DPRK maintains its stability and is integrated gradually both economically and politically into the international community."¹⁸⁷ Its priority is to ensure that North Korea remains intact and is governed by a friendly regime.¹⁸⁸

China has improved its relationship with South Korea as a counterbalance to U.S. influence of South Korea's diplomacy and approach to the nuclear crisis.¹⁸⁹ As both China and South Korea place high value on stability on the Korean peninsula, they appear determined to cooperate on a similar approach of "inducements" for North Korea, instead of "punishments."¹⁹⁰

Experts agree that China's primary contribution to the Six-Party Talks has been bringing North Korea to the multilateral negotiating table, rather than producing any concrete movement by North Korea toward halting its nuclear development.¹⁹¹ China remains reluctant to exert any pressure on North Korea that would challenge the stability of the regime. Ultimately, this establishes a contradictory set of objectives to those of the Six-Party Talks and supports maintenance of the status quo.

It has been more than a year since the last session of the Six-Party Talks. Dr. Friedberg warned, "If the present standoff continues, and Pyongyang begins to accumulate a substantial stockpile of fissile material, the danger that it will be tempted to sell or transfer some of it to terrorists or other rogue states is likely to grow."¹⁹² Greatly complicating this picture, and threatening the continuation of efforts to rejuvenate the Six-Party Talks, is the low-yield nuclear test North Korea conducted in early October. As the figurative shock waves are fully felt in the power centers of Asia, one possible result is that other nations will conclude they now must obtain nuclear capability.¹⁹³

In light of these developments, Dr. Asher urged the U.S. government to rethink its strategy for addressing North Korea's nuclearization¹⁹⁴ and the roles it, the other nations that have participated in the Six-Party Talks, and the United Nations can play to mitigate the damage that has been caused already.

China's Proliferation to Iran and Its Role in Iran's Nuclear Weapons Development

China and Iran have had a long relationship. More recently, during the 1990s, in order to meet its domestic reconstruction needs after the Iran-Iraq war and to offset a deficiency in domestic investment, Iran increased oil production to generate export revenues and increase its holdings of foreign reserves. At the same time, China's requirement for imported petroleum was growing substantially (it became a net oil importer in 1993), and China began to explore relationships in the Middle East to enhance its energy security.¹⁹⁵ Dr. Calabrese, of the Middle East Institute claims that the U.S. arms embargo and economic sanctions on Iran following the U.S. Embassy hostage crisis of the late 1970's opened the door for greater Chinese involvement in Iran, because they forced Iran to seek alternative economic partners.¹⁹⁶

A significant aspect of China's current relationship with Iran is its continued support for developing Iran's weapons programs and

capabilities. Ilan Berman, Vice President for Policy at the American Foreign Policy Council, testified before the Commission that the trends in Sino-Iranian relations are toward a growing proliferation partnership and increasing security cooperation.¹⁹⁷

Chinese companies and government organizations continue to assist Iran in creating self-sufficient ballistic missile capabilities. In August 2006, the U.S. Department of the Treasury sanctioned the Great Wall Airlines Company Limited, a cargo airline jointly owned by Chinese and Singaporean firms, for transporting missile-related and dual-use components to Iran's military.¹⁹⁸ Assistant Secretary Rodman also mentioned that "a Chinese firm continued to supply probably MTCR-controlled items and dual-use items to an Iranian missile production organization in late 2005 and 2006 and has prepared other raw materials for shipment to Iran," and that a Chinese "serial proliferator" located in Beijing has supplied materials to Iran's missile industry since at least 2004.¹⁹⁹ China also has delivered missile guidance systems and solid-fuel missile technology to Iran.²⁰⁰

Additionally, China has allowed the transfer of weapons and technology across its territory from North Korea to Iran (and other locations). A Congressional Research Service report on China's proliferation record states that, "[f]rom April to July 2003, China reportedly gave overflight rights to Iranian Il-76 cargo planes that flew to North Korea at least six times to pick up wooden crates suspected of containing cruise missiles."²⁰¹ After U.S. protest in June 2005, China denied over-flight rights for an Iranian plane departing from North Korea.²⁰²

Furthermore, China has supported Iran's development of chemical weapons. On December 23, 2005, the Administration imposed sanctions on the North China Industries Corporation (NORINCO) and five other Chinese companies for missile and chemical weapons proliferation.²⁰³ Despite the sanctions, Mr. Berman testified that Chinese firms remain actively engaged in transferring dual-use items that could be used to develop a chemical weapons stockpile.²⁰⁴

A primary concern for U.S. security is that these transferred items and technology will in turn be transferred outside Iran to its proxy groups or to other rogue nations. Even if it desired to assert such control, it would be very difficult for China to control such third party transfers. The consequences of such transfers could seriously damage Chinese and American interests in the Middle East by threatening regional security. For example, Assistant Secretary Rodman confirmed that during July 2006, Hezbollah used Chinese-designed C-802 "SILKWORM" anti-ship cruise missiles,²⁰⁵ which Mr. Berman testified the Israeli government had no knowledge Hezbollah possessed,²⁰⁶ to attack an Israeli naval vessel. In this way, China's transfer of these missiles to Iran played a role in the conflict between Israel and Hezbollah.

Although China's missile sale was a conventional weapons transfer, the willingness of Iran to retransfer these items to a terrorist organization heightens U.S. concerns over China's willingness to provide arms to Iran. Not only could terrorist organizations use Chinese arms obtained from Iran to disrupt the region, but Iran itself could use Chinese arms against U.S. troops or our allies in the region.

Additionally, Dr. Ehsan Ahrari of Strategic Paradigms Consultancy testified that China's transfer of military items and technologies to Iran may affect U.S. relations with Taiwan. He argued that Beijing uses its transfers as leverage in negotiating with the United States concerning U.S. military transfers to and other support for Taiwan.²⁰⁷

While China suspended the sale of nuclear reactors to Iran and in 1997 secretly promised not to aid Iran's nuclear program, Director of Central Intelligence George Tenet said in 2003 testimony to Congress that Chinese firms might be involved with Iran's nuclear program; this statement was reaffirmed in 2004 by the Director of the Defense Intelligence Agency.²⁰⁸ Although China's missile proliferation to Iran has flourished, Assistant Secretary DeSutter noted in 2006 that China's nuclear activities with Iran have waned in response to the international attention paid to Iran's nuclear program.²⁰⁹ Despite the lack of evidence of direct transfers, some experts believe that China continues to support Iran's technological advancements and training of nuclear physicists.²¹⁰

In 2004, the International Atomic Energy Agency (IAEA) reported that Iran failed to disclose its nuclear programs and also failed to meet its obligations under its safeguards agreement.²¹¹ China wanted to resolve this issue within the IAEA and resisted referring the Iran case to the U.N. Security Council. It maintained this position even after it voted in February 2006 to support a resolution reporting Iran to the Security Council. In May, after China and Russia blocked a Security Council resolution under Chapter VII of the U.N. Charter, which could have authorized U.N. economic sanctions against Iran, the United States agreed to support a new diplomatic effort.²¹² This resulted in a presentation to Iran in June by the United States, the other permanent members of the Security Council, and Germany of a package of incentives to end its uranium enrichment program and allow IAEA inspections.²¹³ Iran announced that it would review the offer and respond in late August.

On August 1, with China voting in favor, the U.N. Security Council passed Resolution 1696,²¹⁴ demanding that Iran suspend enrichment activities and implement IAEA transparency measures; endorsing proposals by China and others for a "long-term comprehensive arrangement" intended to restore confidence in Iran's peaceful nuclear program; and expressing the intent of the Security Council to take additional measures if Iran does not comply with the resolution.²¹⁵ Although, on first impression, China's vote in favor of this resolution may seem inconsistent with its past positions concerning nuclear activity by both Iran and North Korea, in fact it is very much in character: typically China will endorse, or at least will not impede approval of, multilateral statements condemning internal actions of another country, but will not support the imposition of sanctions on the country. China has worked consistently to prevent multilateral sanctions against Iran because of its belief that sanctions violate state sovereignty.²¹⁶

Prior to the August 31 deadline set by the Security Council, Iran denounced the demands to abandon its nuclear work. China responded by reiterating both its desire for Iran to halt its program and its opposition to sanctions, saying, "China has always believed

that seeking a peaceful resolution to the Iranian nuclear issue through diplomatic talks is the best choice and in the interests of all parties concerned.”²¹⁷ Regardless of China’s support for Security Council Resolution 1696, Assistant Secretary Rodman concluded that China and Russia both have failed to “back up this vote with action.”²¹⁸

Mr. Berman testified that China’s obstructionism and moral support for the Iranian nuclear program have created “international deadlock” and allowed Iran to continue development of its nuclear capability.²¹⁹ Also China’s willingness to provide materials and technical assistance without political constraints and pre-conditions²²⁰ strengthens relations between the two countries and lends support to the argument that another significant motivation for Iran’s relationship with China is to diminish U.S. primacy in the Middle East and elsewhere.

On the other hand, China’s relations with Iran primarily are driven by its need for oil,²²¹ and concern that Iran could deny China access to oil there. (See this Report’s section on China’s energy activities [Chapter 2, Section 3] for more information on Sino-Iranian energy cooperation.) China does not perceive the possible development of Iranian hegemony in the Middle East as a significant threat as long as its ability to obtain petroleum from Iran remains stable.²²² Moreover, Mr. Berman testified that Iran’s nuclearization likely will instigate a new arms race in the region. China stands to benefit materially from purveying arms to the nations caught in such a race, especially if Saudi Arabia modernizes its ballistic missile arsenal; this may further impede efforts to enlist effective Chinese participation in multilateral efforts to slow or stop Iran’s nuclear development.²²³

As a result of the link between China’s economic diplomacy toward Iran and its political opposition to international efforts to limit Iran’s nuclear weapons development, the United States cannot rely on China to play a constructive role in the resolution of this crisis, especially if that resolution involves imposing sanctions on Iran.²²⁴

Mr. Berman concluded that China’s support of Iran is logical.²²⁵ He believes that China’s objectives in supporting Iran parallel U.S. objectives in supporting Saudi Arabia,²²⁶ in that the vital role Iran plays in helping to meet China’s energy needs takes precedence over China’s concerns and considerations in other areas.

Assistant Secretary DeSutter concluded that sanctions applied to Iran with the support of China and Russia are likely to produce the most desirable outcome to the Iran nuclear crisis.²²⁷ Moreover, Mr. Berman maintained that if the United States wants China to cooperate in approving and implementing multilateral sanctions, U.S. policy should “be aimed at providing the Chinese government with the proper information about the scope and maturity of the Iranian threat.”²²⁸ The United States should be demonstrating how Chinese interests will be severely damaged if China is not involved actively in sculpting a peaceful resolution to this crisis,²²⁹ and spelling out to Chinese officials how other options for pressuring Iran to stop its nuclearization would be more invasive and destructive to Iran’s economy,²³⁰ and potentially to China’s investments in Iran.

Becoming a Responsible Stakeholder in Nonproliferation

China has a history of proliferation, but since 1991 has made numerous nonproliferation commitments both in the form of multilateral agreements and in the form of domestic policies and laws.²³¹ Yet, despite China's enactment of export control laws and other domestic nonproliferation laws and requirements, and its accession to several multilateral nonproliferation treaties and regimes, China's proliferation activities continue to raise concerns, especially when they violate China's international agreements. China's laxity in this respect does not adequately support international peace and stability, diplomatic resolutions to proliferation challenges, or the improvement of U.S.-China relations.

The Commission believes that responsible stakeholders effectively participate in international efforts to prevent proliferation; ensure they are not themselves proliferation sources or being used as proliferation conduits; and honor the commitments they have made to multilateral nonproliferation treaties and regimes, agencies, and efforts.

The Commission believes that for a nation to combat proliferation activities effectively, it must establish strong export control and transit control laws and regulations;²³² ensure that manufacturers and merchants know and understand those laws and regulations; and impartially and consistently enforce those laws and regulations. China's record in this respect reveals many gaps and lapses, and these need to be called more forcefully to China's attention. Some of these are attributable to weak or ambiguous laws or regulations; some are attributable to weak support by the central government, sending the signal that violations may not be seen as serious infractions; some are attributable to insufficient penalties for violations, which proliferators simply accept as "a cost of doing business;" and some are attributable to inadequate commitment to enforce laws and regulations, including insufficient dedication of resources to border control and other enforcement efforts.

Assistant Secretary of State DeSutter stated that the role of the United States and its friends and allies is to monitor "the will of the Chinese government to take the concrete steps necessary to implement [its] regulations clearly and fully, with vigor and transparency."²³³ Deputy Assistant Secretary of State Christensen noted in his testimony that the United States needs to refer to China's own legal requirements to identify enforcement lapses.²³⁴ Additionally, Assistant Secretary of Defense Rodman asserted that China's domestic nonproliferation efforts should focus on tightening export control regulations to eliminate ambiguities, addressing deficiencies in criteria for licensing, improving mechanisms for identifying potential export control violators, and developing procedures for enforcing border controls.²³⁵ In this regard, China needs competent technical assistance in establishing and operating an export control system that meets international standards.

In addition to adhering to internationally-accepted rules and standards, responsible leading nations also must act to enforce those rules and norms when other states fail to comply.²³⁶ If it is to secure recognition as a responsible stakeholder, China not only must demonstrate its adherence to its international nonproliferation agreements and its own laws and regulations, it also must

align its interests with those of the international community and work constructively as a member of that community to obtain compliance with the community's standards and objectives rather than pursuing only China's unilateral advantage.²³⁷ China's actions to date with regard to the North Korean and Iranian nuclear crises suggest that it has not reoriented its policies or objectives in this way.

China has taken some favorable steps. In 2004 China joined the Nuclear Suppliers Group (NSG),²³⁸ a multilateral nonproliferation/export control regime. China also has supported U.N. Security Council Resolutions 1540, 1695, and 1696,²³⁹ all of which affirm the necessity of international cooperation to curb proliferation. However, China has continued to resist imposing sanctions on either Iran or North Korea for their nuclear proliferation activities (although after North Korea's October 2006 nuclear test China supported "carefully targeted" sanctions on North Korea). But to date, China has not effectively leveraged its position of power and influence with either nation to obtain a suitable resolution to those two crises. Further, China so far has been unwilling to join or participate in the multilateral Proliferation Security Initiative²⁴⁰ intended to strengthen efforts to prohibit and prevent the international transfer of banned weapons and technology.

SECTION 3: CHINA'S ENERGY NEEDS AND STRATEGIES

The Commission shall investigate and report on "ENERGY—The effect of the large and growing economy of the People's Republic of China on world energy supplies and the role the United States can play (including through joint research and development efforts and technological assistance) in influencing the energy policy of the People's Republic of China."

Key Findings

- China's strategy of securing ownership and control of oil and natural gas assets abroad could substantially affect U.S. energy security—reducing the ability of the global petroleum market to ameliorate temporary and limited petroleum supply disruptions in the United States and elsewhere.
- In 2005, China became the second largest international oil consumer after the United States, with a daily demand of 5.5 million barrels per day.²⁴¹ In 2006, China will account for 38 percent of the total growth in world oil demand.²⁴² The continuation of China's dramatic year-over-year increases of nearly half a million barrels per day (an increase of approximately 16 percent in 2005 and 14 percent in 2006)²⁴³ in petroleum consumption will place growing stress on the world's energy resources and distribution systems, which will affect the supply available to the United States and the cost of that supply.
- China's energy policies, taken as a whole, are not consistent with the economic or geopolitical behavior of a responsible stakeholder; they distort markets and destabilize volatile regions. As

China's energy needs and consumption grow, its failure to observe these international norms becomes increasingly problematic.

- The air pollution resulting from China's energy use policies and practices not only is exacting a toll on the health of China's population and ecology but also is detrimentally affecting the air quality of the western United States.
- In recent years, China has made progress in instituting, codifying, and enforcing environmental standards and controls relating to fuel consumption and has pursued cleaner coal-burning technologies, but still faces a daunting air and water pollution crisis. If China does not address these problems aggressively, it will exacerbate what is already an environmental catastrophe.
- Some U.S. cooperative efforts with China on energy efficiency and environmental friendliness have realized success, offering limited encouragement that the rate of growth of China's energy consumption can be slowed and the environmental consequences of its energy use mitigated. Such results are profoundly in the interest of the United States as well as China.

China's Energy Security Policy

China's energy security policy has three main objectives: to secure an adequate energy supply to meet industrial, residential, and transportation needs; to keep prices low for domestic consumption; and to ensure secure delivery.²⁴⁴ The government's determination to continue strong economic growth, intensified by its fear of domestic instability if growth slows, is of key importance in the formulation of Beijing's energy policies.

Because of this sector's importance, the government has been reluctant to relinquish control of the energy sector to private or quasi-private organizations. Similarly, the government has been unwilling to trust the world's free market dependably to meet China's petroleum needs; it views state ownership of energy assets, i.e. production of its own reserves and purchasing oil at the wellhead, as more secure than reliance on the world market for trade oil.²⁴⁵ This concept is fundamentally at variance with the concept of energy security to which the United States adheres: participation in and dependence on the international market and diversification of resources. This constitutes a significant difference in approach between the United States and China. That difference was raised in mid-2005 when the Chinese National Offshore Oil Corporation (CNOOC) sought to purchase the American oil company Unocal in order to acquire and control its reserves located in various portions of the globe.

China has enunciated and demonstrated a commitment to diversify geographically its sources of petroleum. Deng Zhenghong, Enterprise Manager for Chinese national oil company Sinopec, emphasized the need for petroleum imports and the strategy of Chinese overseas oil activities when he stated that China's overseas oil investments follow a "sixteen character guideline": "Consolidate the Middle East, develop the surrounding regions [border states including those in Central and Southeast Asia and Russia], expand in Africa, and explore the Americas."²⁴⁶ This principle emphasizes di-

rectly connecting with resources abroad, without relying upon multinational companies.²⁴⁷

China's preference for equity oil investments abroad (of purchasing oil at the wellhead) is officially termed the "go-out strategy,"²⁴⁸ and China is pursuing this strategy vigorously. From the 1990s to 2005, China's cumulative overseas investment in oil and gas was \$7 billion;²⁴⁹ from June 2005 to June 2006, the value of China's acquisitions was \$11.97 billion.²⁵⁰ This represents a dramatic upswing in China's equity oil investments, and although China's holdings and current production do not represent a significant proportion of global oil reserves, they document an assertive policy to secure oil at the wellhead.

China relies upon its national oil companies to implement this "go-out" policy. As expressed in 2004 by Tan Zhuzhou, President of the China Petroleum and Chemical Industry Association, "This involves Chinese firms proactively going out to other parts of the world such as Africa and South America and applying their technical expertise and financial resources to the exploitation of oil resources there. This will enable us to secure multiple sources, avoid the risks of over-dependency on any one source and reduce the effects of price fluctuations."²⁵¹ China seeks geostrategic opportunities through its energy acquisitions, and its companies display more willingness to assume risks above those normally accepted by Western oil companies. Chinese national oil companies prefer to invest where countries have energy resources; where Chinese companies face limited competition due to the absence of U.S. oil companies;²⁵² or where the United States or other countries will not invest for moral reasons.

Although there have been public offerings of the stock of some of China's oil companies, the central government remains the sole or majority shareholder in most of those companies.²⁵³ A report on China's overseas oil investments commissioned by this Commission concluded, "China's three major state oil firms, which the government has sought to nurture, giving them pride of place among the country's state-owned enterprises, have also acquired considerable influence over energy policy."²⁵⁴ It is not surprising that this directly affects how they prioritize and strategize their investments.²⁵⁵ These oil companies operate partially according to commercial principles, but in essence they also act as quasi-government organizations looking to shape and to fulfill a national security strategy.²⁵⁶

Their ownership and control also significantly affect the financial strength and flexibility the national oil companies can employ in pursuit of their objectives. Their deep-pocket financing was raised as an issue during the CNOOC bid for Unocal last year. Another concern is that Chinese firms do not face the same reporting obligations to their government or investors, which complicates the ability to track their transactions with foreign governments.²⁵⁷ As Dr. Erica Downs, a China Energy Fellow at The Brookings Institution, explained in testimony before the Commission, "... China's national oil companies are employing a number of tactics that are unavailable to the international oil companies because ultimately it comes down to different shareholder values ... the government

is willing to accept a lower rate of return than that which international oil companies accept.”²⁵⁸

Underlying the “go-out strategy” is China’s hope that, in a time of a global petroleum supply crisis, the direct production of oil in various overseas locations by Chinese oil companies can ensure China will continue to receive the supply of oil it needs.²⁵⁹ However, Dr. Downs pointed out in her testimony that this concept is complicated by several vulnerabilities China currently faces, namely the price of oil, and its transportation.

Given that such a high proportion—43 percent in 2004²⁶⁰—of the petroleum China consumes is acquired externally through imports (and that this proportion is anticipated to increase as demand increases in accord with projections), China’s energy security relies to a considerable extent on the ocean tankers that transport oil and natural gas to China from abroad. The 2006 Department of Defense report on the *Military Power of the People’s Republic of China* noted that more than 80 percent of China’s oil imports passed through the Strait of Malacca.²⁶¹ As a result, “China believes that it is vulnerable to disruptions of sea lines of communication (SLOCs) due to U.S. naval dominance, and to potential security problems in the Straits [sic] of Malacca.”²⁶²

In November 2003, this perceived vulnerability was enunciated by President Hu Jintao when he discussed the “Malacca dilemma” at an economic conference in Beijing. President Hu expressed concern about “certain powers” that have “encroached on and tried to control the navigation route through the strait,” and he urged China to develop a new oil security strategy.²⁶³ Cortez Cooper, Director of East Asian Studies at Hicks and Associates, Inc., described one likely strategy in his testimony to the Commission when he noted that because of China’s increasing reliance upon petroleum imports and international trade, Beijing hopes to concentrate on the Strait of Malacca, the Indian Ocean, and the Persian Gulf, including developing blue water naval capabilities that can operate at such a distance from China.²⁶⁴ Additionally, China has pursued “acquisition of naval port-call rights along the sea lanes of the Indian Ocean and Arabian Sea, [and] arms sales to countries with which Chinese oil companies have contracts . . .”²⁶⁵ in an attempt to improve oil transportation security.

Further, in 2005 only nine percent of Chinese oil imports were transported to China using Chinese-owned ships;²⁶⁶ it must rely substantially on other countries’ vessels for the majority of its oil and gas imports. This situation undoubtedly is a source of discomfort and concern to the Chinese leadership, and has prompted Chinese leaders to recognize the importance of a “strategic transport system” and call for an expanded supertanker fleet to increase China’s oil transport capacity.²⁶⁷

Another way China is responding to these transportation vulnerabilities is to try to construct or acquire pipelines that can be used to transport oil and gas directly from oilfields to China. Recently China has worked aggressively to obtain or construct pipelines to or through Central Asia,²⁶⁸ including lines from Iran and Kazakhstan. As Dr. Downs noted, China perceives “overland imports” as more secure than “seaborne imports”²⁶⁹ because “overland imports” do not traverse sea lines of communication that China

cannot protect. Moreover, construction and use of direct pipelines between Central Asia and China are not dependent on Russia's agreement.²⁷⁰ Notwithstanding its concerns about Russia, China also has sought construction of a pipeline that would carry petroleum directly from Russia.²⁷¹ In these ways, China is attempting to minimize the risk of significant supply disruptions. U.S. concerns about pipelines with a Chinese terminus stem from the fact already described: Wherever it can do so, China is developing petroleum fields so it fully controls the oil and gas they produce, and pipelines facilitate its actualization of this strategy.

Historically, China's energy policy has emphasized "supply expansion over demand moderation,"²⁷² and this has produced a dramatic rise in energy consumption over the past 15 years. Energy efficiency and conservation have not been major objectives. According to the National Development and Reform Commission, one of China's energy policy-making bodies, China's energy efficiency falls 10 percentage points below that of the aggregate of developed nations, indicating a significant waste of the energy resources China currently has and is using.²⁷³

China's energy situation and policies are greatly complicated by the severe environmental pollution of the air, water, and soil resources that results from the emissions from burning fossil fuels. This is having calamitous effects on the health of the Chinese people and producing acid rain, polluting the water and soil, and producing carbon dioxide. Among the consequences for China are increased health problems and consequent demands for medical care, environmental degradation, and social unrest that threatens the stability and order so valued by China's leadership. This unrest is illustrated by a December 2005 incident near the border with Hong Kong that occurred when villagers who feared construction of a coal-fired energy plant would increase pollution confronted police and reportedly were fired upon.²⁷⁴

The evidence suggests that China's leadership is awakening to a number of these problems and is taking steps to try to mitigate them. The government has begun to encourage energy consumers to moderate their energy demands rather than reflexively to assume the only acceptable response to increased demand is to find a way to increase the energy supply.²⁷⁵ This has included some "aggressive energy initiatives" aimed at simultaneously improving energy efficiency while increasing domestic energy production.²⁷⁶ Principal Deputy Assistant Secretary of Energy Katharine Ann Fredriksen described these to the Commission, including large-scale coal liquefaction projects, new power plants fueled by natural gas, energy efficiency improvements in large buildings, and use of alternative and renewable energy resources.²⁷⁷ In addition, China has adopted aggressive automobile gasoline mileage standards and has instituted a new tax structure on passenger cars designed to reward owners of economical vehicles.²⁷⁸ While new laws have been enacted to address environmental and efficiency concerns, problems with implementation and enforcement persist.

China's Energy Supply

Coal

Reflecting the significance of coal in China's energy picture, Dr. Downs testified that "Coal is king in China." Coal provides approximately two-thirds of China's total energy needs, and demand continues to increase, spurred by urban growth and industrialization.²⁷⁹ China consumes more coal than the United States, the European Union, and Japan combined.²⁸⁰ China's large domestic reserves enable it to be essentially self-sufficient in coal production, and the government monitors coal prices to keep them artificially low for the public.²⁸¹

Environmental pollution and risks to public health are prominent results of China's high coal consumption. As a comparison, China's fossil fuel combustion released 22.5 million tons of sulfur in 2004, more than twice the amount released by the United States.²⁸² It produces acid rain and contributes to 400,000 premature deaths a year in China.²⁸³ Dr. Downs testified that China recognizes the significant environmental and political costs of burning coal.²⁸⁴ The Chinese government has been working with the U.S. Department of Energy's Fossil Energy Office to develop and implement pollution controls,²⁸⁵ but the objective of lowered emissions can only be achieved if major investments are made in clean coal technologies, and to date China has been unable or unwilling to make sufficient investments of this kind.

Coal has a very low cost relative to the cost of other energy resources in China, partly due to government pricing policies. Those who use it are either unable or unwilling to afford the cost of more expensive cleaner fuels. Continued dependence on coal, in turn, creates a disincentive for increased investment in developing fuel processes that are cleaner but also affordable. Nonetheless, there are some glimmers of hope. As Principal Deputy Assistant Secretary Fredriksen noted in her testimony, China has participated in the U.S. Department of Energy's FutureGen initiative, which "seeks to realize the world's first near-zero emissions power plant that will produce electricity and hydrogen from coal while capturing and storing carbon dioxide."²⁸⁶ China also has been considering investing approximately \$24 billion in large-scale coal liquefaction projects which, if completed, could replace up to one million barrels of oil per day.²⁸⁷

Oil and Natural Gas

Oil accounts for approximately 23 percent of China's energy consumption. In 2005, China became the second largest global oil consumer after the United States, with a daily demand of 6.5 million barrels per day.²⁸⁸ By 2030, the Department of Energy predicts that China's oil needs will equal 13 percent of global demand.²⁸⁹ Facing a decline in domestic production,²⁹⁰ China has increased offshore production and is attempting to enhance residual oil recovery in existing fields. China hopes that offshore production eventually will become its largest source of domestic oil.²⁹¹ To bridge the gap between domestic demand and supply, China relies upon oil imports, which have risen in recent years. Overall, China imports at

least 43 percent of the oil it needs.²⁹² Until 2006, Saudi Arabia had been China's largest source for crude oil imports, but in February, Angola moved into first place.²⁹³

To secure sufficient petroleum imports, China has focused on equity investments, and has been looking beyond its traditional principal suppliers in the Middle East. China made new petroleum investments from June 2005 to June 2006 in thirteen countries, including Angola, Nigeria, Equatorial Guinea, Venezuela, Canada, Peru, and Syria.²⁹⁴ However, these investments do not necessarily represent immediate increases in production; rather, they indicate potential production and an expansion and diversification of China's oil investments.

Below is a chart representing China's equity investments from June 2005 to June 2006:

China—Upstream Investment and Reserve Holdings²⁹⁵
June 1, 2005–June 1, 2006
(bbl = barrels)

Country	Interest	Investment Category	Contract Details	Value of Investment	Proven Reserves	Date of Transaction
Angola	Block 15	Oil	Joint venture (20% stake, Sinopec)	\$982 million	700 million bbl	May-06
Angola	Block 17	Oil	Joint venture (25.5% stake, Sinopec)	\$1.1 billion	255 million bbl	May-06
Angola	Block 18	Oil	Concession (40% stake, Sinopec)	\$1.1 billion	280 million bbl	May-06
Canada	Northern Lights (Athabasca) project	Oil sands	40% Sinopec stake in Synenco oil sands project	\$84 million	596 million bbl (bitumen)	Jun-05
Ecuador	Block 15	Oil	PSA (40% stake, CNPC and Sinopec)	\$1.42 billion	36.4 million bbl	Sep-05
Ecuador	Tarapoa and Shiripuno fields, block 14, block 17	Oil	Concessions (100% of Tarapoa and Shiripuno, 75% block 14, 70% block 17)	Value Included in the line above (\$1.42 billion)	125.6 million bbl	Sep-05

China—Upstream Investment and Reserve Holdings²⁹⁵—
Continued
June 1, 2005–June 1, 2006
(bbl = barrels)

Country	Interest	Investment Category	Contract Details	Value of Investment	Proven Reserves	Date of Transaction
Equatorial Guinea	Block S	Oil	PSC signed by CNOOC	Undisclosed	Unknown (exploration contract; block surrounds the 300 million bbl Ceiba field)	Feb-06
Kazakhstan	PetroKazakhstan	Oil	CNPC purchased Canadian firm PetroKazakhstan	\$4.2 billion	550 million bbl	Oct-05
Kenya	Blocks 1, 9, 10A, L2, L3, L4	Oil	PSCs signed by CNOOC, covering 115,000 km ²	Undisclosed	Unknown (exploration contract)	May-06
Nigeria	OPL 471, 721, 732, 298	Oil	CNPC purchased Canadian firm PetroKazakhstan	\$16.04 million (low signature bonuses in return for large downstream investments)	Unknown (exploration contracts)	May-06
Nigeria	Akpo Field (offshore license 130)	Oil	PSA (45% stake held by CNOOC)	\$2.4 billion	600 million bbl	Jan-06
Peru	Blocks 111 and 113	Oil	E&P contracts signed by CNPC	\$83 million	Unknown (exploration contract)	Dec-05
Syria	Stake in Al-Furat Petroleum Co.	Oil	17% stake held by CNPC in Al-Furat Petroleum Co.	\$586 million	66.3 million bbl	Dec-05
TOTALS:				\$11.97 billion	3.2093 billion bbl	
				1147.71 bn bbl	Global proven reserves	
				3.21 bn bbl	Chinese overseas acquisitions (2005–2006)	
				0.3%	Chinese acquisitions as percentage of total world reserves	

Of China's national oil companies, the China National Petroleum Corporation (CNPC) has been most active and successful in acquiring assets abroad; CNPC currently holds exploration and production contracts in 21 countries.²⁹⁶ Sudan is the site of China's largest overseas production,²⁹⁷ and CNPC has invested more than \$8 billion there; these investments include a field in southern Darfur.²⁹⁸ China not only invests in exploration and production in Sudan, but also in Sudanese pipelines to transport pumped oil to Red Sea refineries.²⁹⁹ In October 2005, CNPC purchased PetroKazakhstan, a Canadian-owned company whose assets include pipelines that will be used to transport oil from Kazakhstan to China.³⁰⁰ In August 2006, CNPC and the China Petroleum and Chemical Corporation (Sinopec) agreed to jointly invest \$5 billion in exploration and production projects in Venezuela.³⁰¹

Sinopec, however, operates primarily in Iran. In 2004, Iran awarded Sinopec the rights to develop the Yadavaran oil field, expected to produce 150,000 barrels per day, in exchange for China's commitment to purchase ten million tons of liquefied natural gas each year for 25 years.³⁰² By means of this combined upstream-downstream investment project, China significantly increased its supply of oil and natural gas. In 2006, Sinopec signed another deal with Iran to explore the Gamsar oil block, valued between \$20 million and \$59 million over a four-year period.³⁰³ Also, in August, Sinopec and an Indian national oil company jointly acquired a stake in Colombia's Ominex oil company. This illustrates a decision by China and India to partner in the search for energy resources.³⁰⁴

China's international petroleum activities have not been limited to supply acquisition. Deputy Assistant Secretary Fredriksen noted that China's "lack of adequate refining capacity suitable for heavier Middle Eastern crude oil" is a major concern for its leadership.³⁰⁵ To address this, China is collaborating with Saudi Arabia to build joint-venture refineries in Quanzhou and Qingdao, and is building a refinery in Xinjiang province to refine oil transported by pipeline from Central Asia.³⁰⁶ In July 2006, PetroChina completed an expansion project on a Dalian-based refinery, making that refinery the largest in China.³⁰⁷ Additional projects are under construction in Fujian and Guangdong provinces. China is also investing in the refining capabilities of countries with which it currently has equity investments. It is helping Angola build a refinery, expected to begin operation in 2010;³⁰⁸ in July 2006 China signed a \$2.7 billion agreement with Iran to upgrade Iranian refining capacity.³⁰⁹

Natural gas has not yet become the major actor in the energy sector in China that it has become in the United States, primarily because China lacks an adequate distribution system for natural gas; this limits its use and contributes to its price being higher than that of coal.³¹⁰ Even so, consumption of natural gas is steadily increasing. In June 2006, China became a natural gas importer when the Guangdong liquefied natural gas import terminal opened.³¹¹

To ensure an adequate supply, China also has attempted to expand its access to natural gas. This is presumed to be one of the factors in last year's attempt by CNOOC to purchase U.S. oil company Unocal that holds significant natural gas assets. China has committed to purchase approximately 1 trillion cubic feet of gas in

Turkmenistan beginning in 2009. It also is seeking natural gas from Uzbekistan.³¹² China also has entered a 30-year contract with Burma to purchase 6.5 trillion cubic feet of natural gas,³¹³ which may complicate U.S. and U.N. efforts to obtain changes in the political situation there.

As explained previously in this section, China is working to construct or acquire pipelines, especially in Central Asia, for both oil and natural gas in order to reduce the risks of transporting these commodities to China. China's primary partner in this initiative is Kazakhstan, which China views as the "gateway to Caspian oil and gas reserves."³¹⁴ A 620-mile pipeline from Atasu in northern Kazakhstan to Xinjiang province became operational in May 2006, although Dr. Martha Brill Olcott of the Carnegie Endowment for International Peace testified that sufficient oil to fill the pipeline is not yet available.³¹⁵ China also has proposed building a pipeline across Burma into Yunnan province in southwestern China that would transport Burmese natural gas and possibly serve as an alternate route for Middle Eastern oil to reach China, thereby minimizing use of the Strait of Malacca.³¹⁶

In 2004, China announced plans to construct a strategic-petroleum reserve (SPR) intended to hold stockpiles equivalent to 90 days of imports.³¹⁷ Construction of the Zhenhai reserve, one of four being built in China, was completed in the summer of 2006 and was expected to be ready for use in October 2006.³¹⁸ Although China is not a member of the International Energy Agency (IEA), the stockpile China is developing comports with IEA's standards for the SPRs of IEA member nations. Deputy Assistant Secretary Fredriksen stated that this project is "one of the most significant developments" in China's energy policy,³¹⁹ because it will give China the ability to respond to an oil supply crisis by releasing its own reserves.

Because China is not bound by the obligations of IEA membership, it is uncertain if that is the purpose, or one of the purposes, for establishing its SPR. The Department of Energy has been discussing this issue with China, most recently in September in the U.S.-China Energy Policy Dialogue. Deputy Assistant Secretary Fredriksen noted that, "[w]hile commending China's efforts to build their first state-owned SPR, we have constantly reiterated that the SPR needs to be used to address supply disruption, not to affect global petroleum markets."³²⁰

Nuclear Energy

Although nuclear energy currently provides only a fraction of China's energy, China intends to build an additional 30 nuclear reactors within the next 15 years, allowing nuclear power to provide approximately five percent of the country's total energy needs.³²¹ Deputy Assistant Secretary Fredriksen stated that China is in the final stage of constructing a pressurized water reactor, and the United States is encouraging China to consider Westinghouse Electric Company's bid, the only one it received from a U.S. company.³²² In July 2006, China joined the Generation IV International Forum (GIF) Policy Group that collaborates on "nuclear energy system concepts" for future energy needs.³²³

Renewable Energy

China recently expressed interest in pursuing renewable energy as an option for diversifying its energy supply.³²⁴ In February 2005, China passed the Renewable Energy Law that legalizes the regulatory framework for alternative energy sources and supports research and development and the creation of new facilities.³²⁵ By 2010 China intends to supply 10 percent of its energy needs with renewable energy and has obtained financing for this endeavor from the World Bank and other institutions.³²⁶ In addition, China has become the second-largest producer of hydroelectric power after Canada. With the construction of the controversial Three Gorges Dam and a series of dams on the Yellow River, China's hydroelectric capabilities will continue to grow.³²⁷ Despite these developments, Dr. Downs testified that obtaining widespread use of renewable energy sources in China will be a significant challenge, especially because other fuel sources cannot compete with the low market price of coal, often because of the cost of equipment (e.g., windmills or solar panels) renewable energy sources require.³²⁸

The Debate About Equity Oil Investments

As China increases its equity stakes rather than purchasing oil on the international market, questions have surfaced as to the effect of China's investments on U.S. energy security. In this discussion, two divergent positions have emerged.

One line of thought is that China's oil acquisition strategy diverts oil that otherwise would enter the world oil market, and that this can result in harm to the market and the energy security of its participants including the United States. Those holding this view believe China's strategy is to try to "lock up" petroleum supplies for its exclusive use.³²⁹ In contrast, the United States relies primarily on the international oil market for its oil imports. As international demand for oil increases in the face of a limited supply, economic theory predicts heightened competition that will drive prices higher. If China does not add to the world market the petroleum in the fields it owns and controls, other states must compete for what is left in that market, making the market's prices and supply more vulnerable to shocks and increasing the likelihood of conflicts over limited supplies in the event of a crisis.

If this is the Chinese strategy, it will be harmful to U.S. interests in other ways. Chinese petroleum acquisition efforts have resulted in Chinese actions to protect regimes in nations where China is obtaining petroleum, such as those in Khartoum and Tehran. According to Dr. Downs, "... the risk for Washington is that China's growing dependence on imported oil will increasingly prompt Beijing to give higher priority to oil than to international issues such as the protection of human rights, nuclear nonproliferation, and good governance."³³⁰ As discussed previously in this section, China's oil companies often are active in countries such as Iran, Sudan, and Burma where U.S. oil companies are not present because of boycotts, sanctions, or high political and security risks. These regimes often expect—and receive—a quid pro quo from China. An Iranian newspaper explained that since "we have assured China that its energy and oil needs will be met, we should ask that country to

complete its position and go beyond mere expressions of opposition to the referral of Iran's dossier to the Security Council."³³¹ An additional concern is the extent to which China could affect domestic politics within a country where it is obtaining petroleum to ensure a favorable climate for its activities there.

The alternative line of thought in this debate about China's oil acquisition strategy is that China imports oil from its equity fields that it otherwise would purchase on the international market. This suggests that the effect of China's petroleum acquisition strategy is essentially neutral on the supply of energy available in the international energy market and on those nations that purchase through that market, including the United States. Therefore, China's strategy does not threaten U.S. energy security. Some go further to suggest that China's acquisition strategy may actually benefit the international market. As Deputy Assistant Secretary Fredriksen testified, China usually enters markets with "a higher geopolitical risk than a lot of private sector companies are willing to take on . . . , and so . . . every drop of oil that they now are mining . . . in those countries . . . is oil they're not taking off the international market."³³²

China's acquisitions currently are not significant in terms of the overall international oil market. Its acquisitions between 2005 and 2006—higher than total acquisitions in the previous 15 years—only totaled 0.3 percent of total world reserves.³³³ This amount of oil is very unlikely to affect the world market appreciably even in a time of crisis. Additionally, a report on China's energy activities commissioned by this Commission concluded that China's oil companies could "lock up" resources only by "consistently outbidding other international energy interests and paying above-market rates. Such a policy, however, would strain China's already heavily subsidized retail fuels market, lead to unnecessarily high oil prices, and harm China's overall economy."³³⁴

During the Commission's 2006 hearings, Commissioners asked if China's equity oil is transported exclusively to China or if some is being sold on the market. If China is selling the oil it produces on the market, China cannot be charged with "locking up" supplies for its exclusive use. In support of this argument, Dr. Downs testified that "host countries tend to value the barrels of oil that are produced in their countries at the world market price."³³⁵ Consequently, in a time of crisis, even if China can ensure the oil it produces abroad is delivered to China, the price it will pay likely will be comparable to the price it would have had to pay in the world market—and thus its acquisitions likely will be comparable to what they would have been if it participated in that market.³³⁶

However, the report on China's overseas investments commissioned by the Commission suggests the opposite. The contractor tracked China's investments through open sources in an attempt to document the number of barrels produced by the fields it owns and the number of those barrels that were transported to China. Although Chinese customs data only indicate countries of origin for China's oil imports, and do not identify the specific projects that were its sources, and Chinese oil companies do not reveal detailed information about their activities, the report concluded that "the amount of equity oil flowing into China in 2006 is only about

320,000 [barrels per day], out of total imports of 3.6 million bpd and total Chinese consumption of 7.4 million bpd . . . [M]ore than 90% of its imports do not originate with equity oil projects in which Chinese firms have invested.”³³⁷ Furthermore, the report found that while China has increased its investment activity, only two projects in Kazakhstan and Sudan currently produce more than 100,000 barrels per day in equity oil. Several projects in development, including the Yadavaran field in Iran, have the potential to produce more, but as yet that potential has not been realized.³³⁸ Thus, while representing a small share of world reserves and Chinese imports, China’s current production of equity oil approximately equals the amount of its equity imports,³³⁹ implying that very little Chinese equity oil is being sold on the market.

For its part, Chinese leaders dispute charges that it is trying to “lock up” petroleum resources and have made a concerted effort to “allay U.S. fears of neo-mercantilist policy” by means of government pronouncements and cooperation with the United States in petroleum “upstream” and “downstream” projects.³⁴⁰

Is China a Responsible Stakeholder in the Energy Sector?

China’s growing energy needs, and the necessity for it to seek energy supplies abroad, have created opportunities to gauge whether Beijing’s energy sector policies and activities are those of a responsible stakeholder. In its international petroleum acquisition activities, Beijing is not acting as a responsible stakeholder, although its self-interested actions may reflect rational behavior intended to protect its own supply. The health of energy markets is crucial for sustaining the international economy, and acquiring oil through the market and according to internationally accepted norms for market behavior ensures a fair playing field for oil-importing countries. Yet, China’s acquisition strategy does not support the world market and may prevent efficient allocation of resources, especially in times of global supply disruptions. Its strategy reflects a mercantilist view of global energy resources and does not promote international cooperation in addressing limited supplies of petroleum.

China has made progress in enacting laws and regulations that promote environmental protection and in developing and implementing energy efficiency technologies. Yet its progress continues to be impeded by China’s domestic pricing policies that preserve coal’s status as the cheapest energy source. Without establishing economic incentives for development and use of cleaner fuels and renewable energy sources, and for increasing energy efficiency, China’s environmental problems will continue to worsen, and the transnational effects of China’s pollution increasingly will affect other nations including the United States.

A derivative effect of China’s energy acquisition policy and activities is that China has made it more difficult for the world community to secure acceptable resolutions to genocide and other humanitarian crises, nuclear proliferation, human rights violations, anti-democratic political activities, and corruption in several locations where it is active in petroleum extraction, including Sudan, Burma, and Iran. This is the case because China provides support to the purveyors of these deplorable circumstances in order to facilitate

its acquisition of petroleum and other resources those purveyors control.

RECOMMENDATIONS

China's Regional Activities

- The Commission recommends that Congress urge the Administration to seek direct dialogue and cooperation with China with regard to securing a resolution to the conflict in the Darfur region of Sudan that will halt the genocide occurring there and provide security and basic human rights for the affected population. Congress should instruct the Administration to report semiannually on China's actions in Sudan and any progress that has been made through dialogue with China.
- The Commission recommends that Congress encourage the Administration to intensify engagement with Latin American nations in light of expanding Chinese interests in the region.
- The Commission recommends that Congress encourage the Administration to seek observer status for the United States in the Shanghai Cooperation Organization and that Congress also encourage the Administration to monitor closely Iran's participation in this organization.
- The Commission recommends that in response to China's efforts to isolate Taiwan, Congress encourage the Administration to implement a long-term policy to facilitate Taiwan's participation in international organizations and activities for which statehood is not a prerequisite, such as the World Health Organization, the Community of Democracy, the Proliferation Security Initiative, and other multilateral public health, counterproliferation, counterterrorism, and economic organizations as appropriate. Congress should instruct the Administration to report annually on its actions to ensure that Taiwan is not isolated in the world community.
- The Commission recommends that Members of Congress, when visiting mainland China, also visit Hong Kong, and that Congress encourage senior Administration officials, including the Secretary of State, to make visits to Hong Kong part of their travel to China.
- The Commission recommends that Congress extend the reporting requirements in Section 301 of the United States Hong Kong Policy Act of 1992, P.L. 107-115, 22 U.S.C. 5731, for five more years.

China's Proliferation and Involvement in North Korea's and Iran's Nuclearization Activities

- The Commission recommends that Congress urge the Administration to seek high-level dialogue with China intended to obtain strengthened and expanded nonproliferation commitments and activities from China and, in particular, (1) to obtain China's agreement to participate in the Proliferation Security Initiative

and the Illicit Activities Initiative; and (2) to strengthen its export controls and their enforcement. Toward this end, the Commission recommends that Congress—

- direct the Administration to provide increased export control technical assistance to China, and
 - appropriate funds to support that increased assistance.
- The Commission recommends that Congress urge the Administration to seek agreement with China to carry out inspections at sea of ships bound to or from North Korean ports and establish a U.S.-China joint operation to inspect for contraband all shipping containers being moved to or from North Korea when they pass through Chinese ports, in fulfillment of the obligations under U.N. Security Council Resolution 1718 to prevent the sale or transfer of missiles, and nuclear and other weapons-related materials and technologies, to and from North Korea.
 - The Commission recommends that current sanctions against Chinese companies that proliferate equipment and technology related to weapons of mass destruction and their delivery systems be broadened and harmonized for increased effectiveness. The Commission recommends that Congress expand current sanctions regimes to extend penalties to the Chinese parent company of a subsidiary that engages in proliferation activities, regardless of the parent company's knowledge of or involvement in the problematic transaction. Access to U.S. markets (including capital markets), technology transfers, and U.S. government grants and loans should be restricted from proliferating companies and their Chinese parent companies and related subsidiaries irrespective of the related firms' knowledge of the transfers in question.
 - The Commission recommends that Congress instruct the Administration to insist that China fulfill its obligations under U.N. Security Council Resolutions 1695 and 1718 and take more significant measures to denuclearize the Korean peninsula and counter North Korean proliferation activities. The Congress should further instruct the Administration to report semiannually about specific actions the Chinese government has taken in this regard.
 - The Commission recommends that Congress instruct the Administration to engage in a strategic dialogue with China and report to Congress the specific actions that China is taking concerning (1) its past and current proliferation activities to Iran; (2) its public stance in support of Iran's nuclear energy program; and (3) the impact of Iran's secondary proliferating transfers, and to encourage Middle Eastern and European states to seek to persuade China's government to act more responsibly and diligently to curb Chinese proliferation to Iran.

China's Energy Needs and Strategies

- The Commission recommends that Congress support the Administration's current policy dialogues and technical exchanges with China pertaining to energy, and urge the Administration to seek additional opportunities for the United States to assist China to increase energy efficiency, reduce pollution from energy consumption, and facilitate the use of alternative fuels.

- The Commission recommends that Congress obtain detailed information on the nature, specific sources, and extent of China's air pollution, and its detrimental effects both in China and in the rest of the world, with specific attention to the effects in the United States.

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