INTRODUCTION

Early indicators suggest China is quickly emerging from the global recession and resuming its recent economic growth path. While many countries have been struggling with falling income and employment throughout the year, China's gross domestic product is on track to achieve an 8.5 percent gain, according to the International Monetary Fund (IMF).* This relatively rapid recovery, combined with comprehensive industrial policies, also has helped China capture market share from its competitors and add to its foreign currency reserves. China is now the world's largest exporter as well as the largest exporter to the United States. As a result, China's leaders are now proclaiming that their economic model—a blend of subsidies, government control of the market, export-led growth, and selective privatization—is superior.

Buoyed by its continued economic success, China also has grown more confident on the world stage and is seeking to expand its influence. Its leaders have sought a larger voice in international organizations ranging from the International Monetary Fund and the G–20 group of industrialized nations to the United Nations. To its credit, China has also begun to expand its international peacekeeping efforts, most notably by sending several warships to join an international effort to reduce piracy along the east African coast.

This year's report reflects the Commission's concern that despite its accomplishments and growing sense of confidence, China may be moving in the wrong direction and that this affects the U.S.-China relationship. China has yet to embrace the challenge first issued in 2005 by the United States that it become a "responsible stakeholder" in world affairs.† Many of its recent global efforts appear more focused on enhancing China's access to raw materials than on promoting economic or political development, and China has not demonstrated leadership in working to solve difficult problems such as the civil war in Sudan or halting Iran's nuclear weapons program.

Regarding China's economy, the Commission notes a disturbing trend away from the evolution toward a full market system and instead sees steps backward to greater government control. China continues to employ a wide range of subsidies to favored companies and industries within China and to control the value of its currency and provide massive loans from state-owned banks to industries producing over capacity. This approach gives Chinese exporters a substantial price advantage in international markets and disadvantages U.S. companies hoping to export to China. China also continues to lag in enforcing international laws protecting intellectual

*The IMF predicted in October that the U.S. economy would decline by 2.75 percent for the year.

†Robert B. Zoellick, "Whither China: From Membership to Responsibility" (remarks to the National Committee on U.S.-China Relations, New York, NY, September 21, 2005).

property and continues to be identified by the U.S. government and private organizations as the world's largest source of such thefts.

In addition, China's role as the largest purchaser of U.S. government securities has altered the economic relationship between the two countries. China's central bankers have joined a chorus of other officials in Beijing who point to the declining value of the American dollar against internationally traded currencies and suggest that it be replaced as the world's unofficial reserve currency. China's holdings have aroused fears in the United States of increased economic vulnerability to Chinese government decisions.

The Commission has been given the responsibility by Congress to advise it on economic and security policy toward China. The Commission's findings are contained in this, its seventh major Report to Congress. To complete its work, the Commission held seven hearings in Washington, DC, and one field hearing in Rochester, New York. Commissioners attended six classified briefings with five intelligence agencies. Commissioners visited the Chinese cities of Beijing, Xiamen, Nanjing, and Hong Kong. The Commission also contracted for independent research on topics the Commissioners viewed as important to U.S. policy toward China.

China's growing assertiveness is also reflected in its naval modernization. China added two nuclear-powered ballistic missile submarines to its fleet. Even more significant is the navy's adoption of a "show the flag" strategy that includes support for China's acquisition of assets and resources from abroad. China also used its growing naval capabilities to assert a controversial theory of a 200-mile exclusive economic zone where foreign military vessels might be excluded. In March 2009, five Chinese vessels surrounded and stopped the USNS *Impeccable*, an intelligence and surveillance ship operating about 75 miles from Hainan Island, site of a large Chinese submarine base under construction. One other U.S. naval surveillance ship was similarly confronted in 2009 amid demands from China that the United States cease air and sea surveillance inside the 200-mile exclusive economic zone.

China also continues to expand its capability to wage cyber warfare against other nations, to employ more sophisticated methods of espionage, and to increase its ability to obtain military technology surreptitiously from Europe and the United States. China's espionage activities in 2009 continued to evolve into a more targeted collection effort for specific information, much of it directed at obtaining specific western technologies useful in developing advanced weapons.

Cyber intrusions, including the exfiltration of large amounts of information, particularly data from America's largest defense contractors, were on the rise in 2009. Anecdotal and forensic evidence strongly implicates the Chinese government in many of the activities, either directly or through third-party surrogates sponsored by Beijing. Malicious activities directed against Defense Department computers in 2009 were running at a rate of 240 every day, costing as much as $200 million to repair the damage.

Managing these rapid changes and China's increased expectations will be a continuing challenge for Beijing and Washington. Despite China's success in emerging from the recession, China cannot continue to build its export sector and to direct investment into

strategic industries that are already at overcapacity—without doing grave harm to its trading partners, particularly the United States. Unfortunately, the same imbalances among China, the United States, and Europe that caused so much trouble in the global financial sector are continuing to threaten the global economy. This will lead to further tensions.