

CHAPTER 3

CHINA AND THE WORLD

SECTION 1: CHINA AND SOUTH ASIA

Introduction

Although China's assertiveness in Southeast Asia—particularly when it comes to the South China Sea—tends to dominate discourse about China's growing global ambitions, China has also been active in cultivating influence among South Asian countries (Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan, and Sri Lanka). This section surveys China's economic, diplomatic, and security engagement with South Asia. In addition to discussing China's overarching objectives in the region, it profiles China's relationships with South Asia's two largest countries: India and Pakistan. It concludes with an examination of how China's South Asia policies impact the United States, which also has significant and evolving interests in the region. This section draws from the Commission's March 2016 hearing on China-South Asia relations; its June 2016 fact-finding trip to China (Beijing and Kunming) and India (New Delhi and Mumbai); consultations with experts on Chinese and South Asian economics, foreign policy, and security affairs; and open source research and analysis.

China's Objectives in South Asia

China has not publicly articulated a formal South Asia "strategy," although Beijing's key objectives and interests in the region can be observed in its activities in and diplomacy toward these countries. The key interests, concerns, and objectives of China's South Asia strategy fall into four broad categories: (1) checking India's rise by exploiting the India-Pakistan rivalry, (2) expanding economic activity and influence in the region, (3) enhancing access to the Indian Ocean, and (4) countering terrorism and religious extremism (often at the expense of religious freedom and other human rights). These objectives enable China to compete with potential rivals, increase China's overall influence in the region, and diminish the influence of the United States.¹

Check India's Rise by Exploiting the India-Pakistan Rivalry

The overall balance of power between China and India currently is in China's favor,² and Beijing intends to keep it that way. Although India lags behind China in most categories, from economic growth to military might, it is still the most powerful South Asian country, and its influence in greater Asia is expanding. China exploits the longstanding rivalry between India and Pakistan to en-

sure its own ambitions in South Asia are achieved. This strategy aims to keep India so preoccupied with its western neighbor that it will not have the ability to mount a serious challenge to China's power and influence in Asia.³ During the Commission's trip to India, several Indian interlocutors emphasized their perception that China seeks to encircle or contain India.⁴

Figure 1: Map of South Asia



Source: U.S.-China Economic and Security Review Commission, 2016.

China's bilateral relationships with India and Pakistan are informed by the India-Pakistan rivalry. Moreover, China's approach to the broader South Asian region is colored in large part by China's relationships with these two countries. China's relationship with Pakistan has been defined by mutual animosity toward India since the early 1960s (just after Sino-Indian relations began to deteriorate over Tibet and the border dispute, discussed later in this section). This relationship was further forged during the 1962 Sino-Indian border war and the 1965 Indo-Pakistani war (China threatened to enter the latter on Pakistan's behalf).⁵ Since then, China's increasingly sophisticated military assistance to Pakistan—particularly on

missiles and nuclear weapons—has been instrumental to Pakistan’s ability to credibly threaten India’s security. Andrew Small, senior transatlantic fellow at the German Marshall Fund of the United States, summarizes this dynamic in his book, *The China-Pakistan Axis: Asia’s New Geopolitics*:

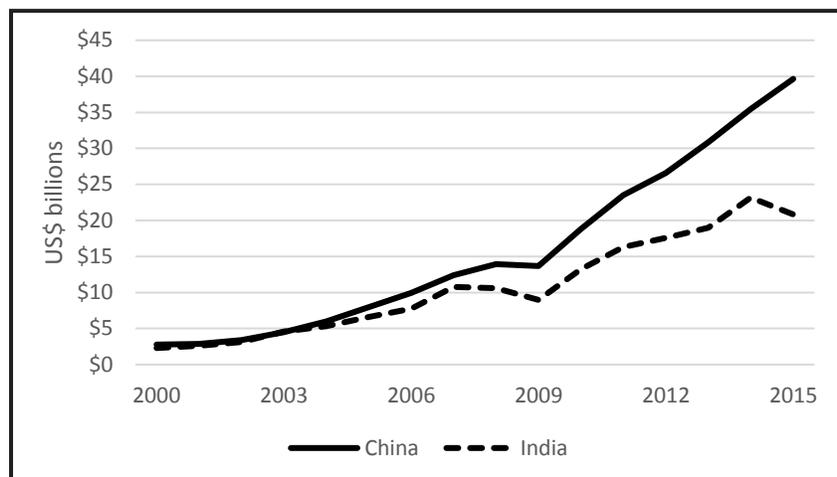
The balancing role that Pakistan plays in Beijing’s India policy goes well beyond forcing India to keep a large number of troops and military assets focused on its western frontier, though that undoubtedly helps. It also ensures that India is kept off balance, distracted, absorbing diplomatic, political, and strategic energies that could otherwise be directed towards China. It puts a constant question mark over India’s aspirations to transcend its own neighborhood. Every time a U.S. secretary of State declares support for New Delhi’s policy to “Look East,” towards the Pacific, China sees another reason to keep India on edge in its own backyard.⁶

For additional discussion of China’s military assistance to Pakistan, see “Bolstering Pakistan’s Defense vis-à-vis India,” later in this section.

Expand Economic Activity and Influence in the Region

Until recently, China lagged far behind India in terms of economic engagement with South Asia, forging a relationship with Pakistan but otherwise remaining a minor player. As Figures 2 and 3 demonstrate, however, over the past decade China’s economic engagement (including trade, loans, and investment) with countries in the region has expanded dramatically, challenging India’s position.⁷ China has been a particularly prolific exporter of manufactured goods—often aided by domestic policies that subsidize production and promote exports—an area where India cannot keep up due to its lagging manufacturing capacity.⁸

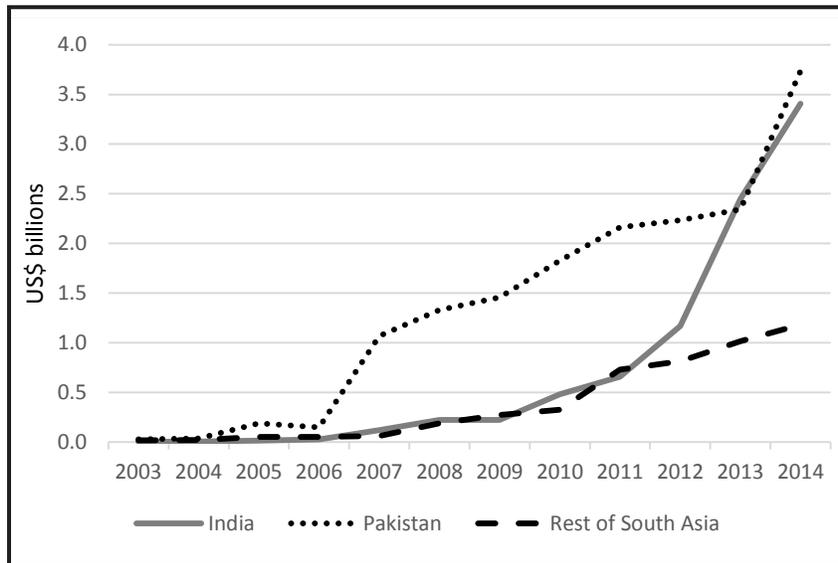
Figure 2: China’s and India’s Trade with South Asia, 2000–2015



Note: Data for China’s trade with South Asia exclude India.
Source: International Monetary Fund, “Direction of Trade Statistics.”

Chinese foreign direct investment (FDI) in the region has also been growing (see Figure 3), with India and Pakistan taking the lion's share. Chinese FDI in Pakistan shows a particularly rapid expansion, jumping 621 percent from 2006 to 2007 before settling into more measured growth (this development appears to correlate with the signing of the China-Pakistan free trade agreement, which went into force in July 2007).⁹

Figure 3: Stock of Chinese FDI in South Asia, 2003–2014



Note: “Rest of South Asia” includes Afghanistan, Bangladesh, Nepal, and Sri Lanka. Data for Bhutan and the Maldives are not available.

Source: China’s Ministry of Commerce via CEIC database.

China’s efforts to expand regional connectivity, embodied by the “One Belt, One Road” (OBOR) initiative (with its land-based “Silk Road Economic Belt” and maritime “21st Century Maritime Silk Road” components, see Figure 4), are gaining some traction. China’s economic activities in South Asia through OBOR present both opportunities and challenges. On the one hand, South Asia is one of the least economically integrated regions in the world. In 2015, the World Bank noted that intraregional trade accounted for only 5 percent of South Asia’s total trade, while intraregional investment accounted for less than 1 percent of total investment. In addition to “limited transport connectivity, onerous logistics and regulatory impediments,” the World Bank pointed to “historical political tensions and mistrust, with cross-border conflicts and security concerns” as causes of this limited regional integration.¹⁰ Chinese-driven transportation and other connectivity infrastructure projects may help alleviate these regional divisions. On the other hand, China’s activities in the region may exacerbate tensions and revive long-simmering conflicts, including those between India and Pakistan. Some of these challenges and opportunities are highlighted here:

- *Sri Lanka*: Sri Lanka is a model case study of China's rising influence in South Asia. While India and Sri Lanka share long-standing historical and cultural ties, and India remains Sri Lanka's top trading partner, China's exports to Sri Lanka are rising fast.¹¹ Outside of Pakistan, Sri Lanka has been the leading beneficiary of Chinese infrastructure investment in South Asia, with nearly \$15 billion worth of projects between 2009 and 2014.¹² In recent years, though, the relationship has been marred by tensions. After a new government came to power in Sri Lanka in January 2015, it demanded a review of several Chinese projects, including the \$1.4 billion Colombo Port City real estate development (the project ultimately went ahead after some terms were renegotiated).^{*} The government raised concerns about environmental impacts of Chinese projects, as well as cozy ties between Chinese contractors and the previous Sri Lankan government.¹³ Hambantota, another major port in Sri Lanka, has also been constructed primarily by Chinese companies.[†] India's worries about China's growing presence in Sri Lanka, which is located on a key trade route in the Indian Ocean, prompted India's Prime Minister Narendra Modi to visit Colombo, signing agreements for new economic assistance, an expanded free trade area, and a civil nuclear deal.¹⁴
- *Bangladesh*: China overtook India as Bangladesh's top source of imports in 2004,¹⁵ displacing many Indian goods, including cotton, which is central to Bangladesh's garment industry.¹⁶ Bangladesh has allocated two special economic zones for Chinese investors in Chittagong, a major port, and Dhaka, the capital.¹⁷ India has also been watching with unease China's investment in Bangladesh's port infrastructure along the Bay of Bengal: China helped upgrade Chittagong and had been pursuing a port project at Sonadia Island.¹⁸ In February 2016, however, Bangladesh quietly closed the Sonadia project, opting instead to develop another deep sea port, which India wants to help build.¹⁹ Bangladesh also permitted Indian cargo ships to access Chittagong Port—a move Deepa M. Ollapally, professor at George Washington University, characterized in her testimony before the Commission as “a historic break from the past.”[‡]²⁰

^{*}The Chinese projects in Sri Lanka that underwent a review were initiated during the administration of President Mahinda Rajapaksa, who had a close relationship with the Chinese government dating back to the last years of the Sri Lankan civil war, when China supplied Sri Lanka with ammunition, jet fighters, and nonmilitary aid. After Maithripala Sirisena narrowly defeated Mr. Rajapaksa to become Sri Lanka's new president, he sharply criticized Mr. Rajapaksa's close ties with China (for example, Hambantota, which received the lion's share of Chinese projects, is Mr. Rajapaksa's hometown and political base), and called for a review of Chinese projects, alleging corruption and overpricing. Ranga Sirilal and Shihar Aneez, “Rajapaksa Comeback Bid Checked by Sri Lanka Bribery Probe,” Reuters, July 24, 2015; Jeff M. Smith, “China's Investments in Sri Lanka: Why Beijing's Bonds Come at a Price,” *Foreign Affairs*, May 23, 2016.

[†]Mr. Rajapaksa said India was offered to develop the Hambantota project first, but rejected the offer. Sandeep Unnithan, “One-Upmanship in Sri Lanka: India and China Fight It out to Rebuild the Island Nation's Economy,” *Daily Mail* (UK), March 30, 2013; Ankit Panda, “China's Sri Lankan Port Ambitions Persist,” *Diplomat* (Japan), July 27, 2015.

[‡]The agreement permitting Indian use of Chittagong and Mongla, another Bangladesh port, was supposed to be signed in 2011, but fell through due to India's failure to sign another bilateral agreement (water-sharing accord for Teesta River). Although the water-sharing agreement remains unsigned, the signing of the Indo-Bangladeshi Land Boundary Agreement in 2015, which resolved a long-standing dispute, has reportedly improved the political climate enough to allow the port deal to advance. Ranjana Narayan, “India, Bangladesh Business Set to Grow through Ports, Waterways,” *Economic Times* (India), June 9, 2015.

- *Pakistan*: In 2015, China and Pakistan launched the China-Pakistan Economic Corridor (CPEC)—which falls under the OBOR umbrella—with the signing of 49 agreements to finance a variety of projects with a total expected value of \$46 billion, including upgrades to Pakistan’s Gwadar Port, oil and gas pipelines, road and railway infrastructure, and a series of energy projects.²¹ CPEC aims to connect Kashgar in China’s Xinjiang Province with Gwadar, located at the edge of the Strait of Hormuz in the Arabian Sea, via 2,000 miles of rail, road, and pipelines (see Figures 4 and 7). China’s economic commitment to Pakistan, if fulfilled, will dwarf U.S. civilian assistance to Pakistan, which totaled around \$5 billion between 2010 and 2014.²² Although much of CPEC remains in the planning stages, financing arrangements have been finalized or are nearing finalization on projects worth \$30 billion, according to Ahsan Iqbal, Pakistan’s Minister for Planning, Development, and Reform.²³ (China’s broader relationship with Pakistan is discussed in greater depth later in this section.)

Figure 4: China’s One Belt, One Road



Source: Galina Petrovskaya, “‘Silk Road’ in EU: Trans-Caspian Transit Bypassing Russia,” *Deutsche Welle*, September 3, 2016. Staff translation.

- *Nepal*: Nepal showcases another facet of China’s ongoing bilateral rivalry with India. Unlike Sri Lanka and Bangladesh, which can give China access to strategically located ports, Nepal is a small, landlocked country entirely dependent on Indian ports and transit infrastructure. Its location, however—squeezed between Tibet and India—makes it an important buffer zone for China (see Figure 5). Concerned that Tibetan exiles living in Nepal may stir dissent in Tibet, China has been expanding its ties with Nepal.* Although trade with India still accounts for

*There are around 20,000 Tibetans living in Nepal. According to a 2014 report by Human Rights Watch, under pressure from China, Nepal’s government has been repressing Tibetan refugees living in the country. Nepalese government abuses against Tibetan refugees documented by

more than half of Nepal's total trade, China has been gaining ground fast; for example, China became the largest source of FDI in Nepal in 2014.²⁴ Recent developments in Nepal's politics gave China a chance to outplay India. Displeased with the new constitution adopted by Nepal in September 2015,* India held an informal blockade on trucks heading to Nepal across India's border, cutting off Nepal's access to vital energy supplies.²⁵ China, which earned much goodwill in Nepal with its swift assistance following the devastating earthquake in April 2015, responded once again, sending fuel and opening trade routes that had been closed since the earthquake.²⁶ In response, Nepal signed several agreements with China, including a permanent arrangement for energy supplies and a transit treaty granting Nepal access to Chinese ports.²⁷ India's blockade ended in February 2016.²⁸ In an effort to normalize the relationship with India, then prime minister of Nepal K.P. Sharma Oli traveled to India in March 2016—his first foreign trip after assuming the position in 2015—and the two sides signed nine agreements, including for infrastructure, rail, and road transit.²⁹

India “Acts East” and Puts Its “Neighborhood First”

Under Prime Minister Modi, India has been pursuing better relations with its neighbors and countries in broader Asia through two important policy initiatives. The first has been the transformation of India's “Look East” policy into an “Act East” policy. The Look East policy dates back to the 1990s, when a worsening domestic economic situation prompted India's government to seek economic opportunities beyond South Asia; the policy later developed to include a strategic dimension.³⁰ Prime Minister Modi used the November 2014 Association of Southeast Asian Nations (ASEAN)-India summit to unveil the Act East policy, which emphasizes more active economic and security cooperation with the region.³¹ On the economic side, Prime Minister Modi focused on—among other goals—boosting trade and increasing connectivity, proposing a new investment vehicle “to facilitate project financing and quick implementation.”³² On the security side, Prime Minister Modi broke with the tradition of India's neutrality on the South China Sea territorial dispute, saying, “For peace and stability in South China Sea, everyone should follow inter-

Human Rights Watch included repatriation and “excessive use of force by police, preventive detention, torture and ill-treatment when detained, intrusive surveillance, and arbitrary application of vaguely formulated and overly broad definitions of security offenses.” Human Rights Watch, “Under China's Shadow: Mistreatment of Tibetans in Nepal,” March 2014, 1, 33–36.

*When Nepal's new constitution came into effect in September 2015, protests opposing the constitution erupted in the southern parts of the country along the Indo-Nepal border (which is an open border, meaning Nepalese and Indian nationals may move freely across the border without passports or visas and may live and work in either country). Among other issues, the communities living along the border—the Madhesi (who share close ethnic ties with Indian people) and Tharu ethnic minorities—expressed concerns that the new constitution would marginalize them. The Indian foreign ministry issued a statement expressing concern over unrest on the border and saying, “We urge that issues on which there are differences should be resolved through dialogue in an atmosphere free from violence and intimidation, and institutionalized in a manner that would enable broad-based ownership and acceptance.” Sanjoy Majumder, “Why Is India Concerned about Nepal's Constitution,” BBC, September 22, 2015.

**India “Acts East” and Puts its “Neighborhood First”—
*Continued***

national norms and law,” without referring to China explicitly.*³³ The Act East policy reaches beyond ASEAN and includes cooperation with Japan and Australia, reflecting Prime Minister Modi’s greater emphasis on maritime security.³⁴

The other important initiative is the “Neighborhood First” policy, aimed at reinforcing India’s commitment to smaller South Asian countries. Dr. Ollapally noted in her testimony to the Commission that the Neighborhood First policy has been evident “both in symbolic terms like the invitation to all neighboring leaders to [Prime Minister] Modi’s inauguration,” and in practical terms like the resolution of the longstanding border dispute with Bangladesh.³⁵

As the examples of Sri Lanka, Bangladesh, and Nepal demonstrate, far from passively accepting China’s growing influence as a substitute for India’s historic dominance in the region, small South Asian countries try to balance the two powers against each other. James Moriarty, then senior advisor at Bower Group Asia, noted in his testimony to the Commission, “When the government of one of these other countries runs into a difficult patch in its relations with India, that government tries to garner support and assistance from China.”³⁶

Expand Influence and Capabilities in the Indian Ocean

The Indian Ocean is growing in importance to China, which relies on sea lines of communication running through the Persian Gulf, Arabian Sea, Indian Ocean, Malacca Strait, and South China Sea for its growing energy needs. Beijing is highly sensitive to the fact that these resources, which are essential to China’s economic productivity (and by extension to China’s domestic stability and the Chinese Communist Party’s political legitimacy), could be interdicted by hostile state or nonstate actors.³⁷ Other strategic interests China perceives it needs to protect include a growing number of Chinese nationals working and living along the Indian Ocean littoral³⁸ and the aforementioned economic investments of Chinese companies in the region.³⁹

The fruits of China’s naval modernization have been manifesting in the Indian Ocean since December 2008, when the People’s Liberation Army (PLA) Navy sent its first antipiracy task force to the Gulf of Aden. Since then, 24 consecutive task groups have maintained a near-continuous presence in the Indian Ocean; the PLA Navy has conducted at least four submarine patrols in the Indian Ocean since 2013;⁴⁰ the PLA Navy conducted its first combat readiness patrol in the Indian Ocean in 2014;⁴¹ and in 2015 China announced it will establish its first ever overseas military logistics facility in

*Leading up to the high-profile July 2016 ruling by the Permanent Court of Arbitration in The Hague in a case about China’s South China Sea claims, Beijing attempted to secure international support for its position. India refrained from taking a position on the case (although Beijing claimed it had Delhi’s support), but soon after the ruling was announced, the Indian minister of state remarked that India “has respected the decision of the International Tribunal to resolve maritime disputes” and “urges all parties to show the utmost respect for UNCLOS.” India’s Ministry of External Affairs, *Closing Remarks by Minister of State for External Affairs Dr. V.K. Singh at the 14th ASEAN-India Foreign Ministers’ Meeting in Vientiane (July 25, 2016)*, July 25, 2016.

Djibouti.⁴² According to David Brewster, senior research fellow at Australian National University's National Security College, "China's overall military modernization program has the long term potential to significantly enhance its ability to project military power into the Indian Ocean region."⁴³

China's "String of Pearls"

Chinese investment in port facilities in strategic locations in the Indian Ocean (including Chittagong in Bangladesh, Gwadar in Pakistan, Colombo and Hambantota in Sri Lanka, Marao in the Maldives, Kyaukpyu in Burma [Myanmar], Lamu in Kenya, and Bagamoyo in Tanzania) is viewed by many in India as part of a concerted plan by China to develop a geopolitical "string of pearls"* to contain India.⁴⁴ Although all of these facilities are intended for commercial use, some experts argue they could eventually serve strategic purposes for the Chinese navy, either as full-fledged naval bases or more limited facilities (as in the case of China's military logistics facility in Djibouti).⁴⁵ This concern was illustrated in 2011 when the Pakistani defense minister at the time told the *Financial Times* that Pakistan had asked China to build a naval base at Gwadar; another Pakistani defense official quoted in the report said, "The naval base is something we hope will allow Chinese vessels to regularly visit in [the] future and also use the place for repair and maintenance of their fleet in the [Indian Ocean region]."⁴⁶ India's worries were further stoked when a Chinese submarine made two port calls in Colombo in 2014, and another submarine surfaced in Karachi, Pakistan, in 2015.⁴⁷

The Chinese government has sought to emphasize the commercial and unthreatening nature of these investments with initiatives like the 21st Century Maritime Silk Road,⁴⁸ but according to South Asian security expert C. Raja Mohan, who heads the Carnegie Endowment for International Peace's India center, the dividing line between a commercial port and a military base is not so distinct. In his words, "If the Chinese military can use a civilian facility, then is that facility still civilian or military? Their ships will have to dock somewhere."⁴⁹ Dean Cheng, senior research fellow at the Heritage Foundation, cautions that Chinese investment in Indian Ocean port facilities does not automatically result in the encircling of India, or at least not easily so, noting: "To become military bases, these investments would require a far larger, more overt military presence, including access treaties with the host countries, hardening of facilities to withstand attack, and most likely the presence of units of the People's Liberation Army."⁵⁰

(See "Rising Competition in the Indian Ocean," later in this section, for an in-depth look at China's interests and activities in the Indian Ocean, and India's response.)

*The "string of pearls" concept originated in 2005, and predicted China would enable the expansion of its military presence in the Indian Ocean region by investing in civilian infrastructure in friendly countries. *Washington Times*, "China Builds up Strategic Sea Lanes," January 17, 2005.

Counter Terrorism and Religious Extremism

As the threat of extremism and terrorism facing China grows,* counterterrorism has become an increasingly important facet of Beijing's engagement with South Asia. Chinese leaders have for decades been concerned about Islamic extremism and terrorism in Xinjiang, China's westernmost region and home to the majority of China's Uyghurs, a mostly Muslim ethnic group. The extent and nature of this threat is difficult to assess given the Chinese government's tendency to conflate and crack down on religious expression, political dissent, extremism, separatism, and terrorism.⁵¹ Nevertheless, open source reporting clearly demonstrates a rise in terrorist attacks in China in recent years.⁵²

Many reported terrorist activities in China have been linked to groups based in (or otherwise supported by groups in) Pakistan and, to a lesser extent, Afghanistan and Central Asia.† In the past, the Chinese government downplayed the role specific foreign countries play in its domestic extremism and terrorism problems. In recent years, however, as terrorist activities have become more frequent and high profile, Beijing has been more willing to apply pressure—privately and publicly—on Pakistan in particular to take steps to eliminate any Pakistan-based extremist, separatist, or terrorist activities that could potentially be directed at China or Chinese citizens abroad.⁵³ Further, cognizant of the influence official and unofficial Pakistani entities have in Afghanistan, Beijing is increasingly insistent that Islamabad commit to promoting the peace and reconciliation process there. China itself has been enhancing its bilateral security engagement with Afghanistan, perceiving a need to take greater responsibility for regional security as U.S. and coalition forces withdraw.⁵⁴

China has engaged with South Asian countries on counterterrorism in multilateral contexts as well. In August 2016, China, Pakistan, Afghanistan, and Tajikistan created the Quadrilateral Cooperation and Coordination Mechanism, an institution that aims to counter terrorism and extremism by “provid[ing] mutual support” in areas such as intelligence sharing and military training and exercises.⁵⁵ In addition, India and Pakistan are both set to join the Shanghai Cooperation Organization,⁵⁶ a Beijing-dominated institution focused on counterterrorism that also includes Russia and Central Asian countries.‡

It is worth noting that even as the Chinese government begins to take the threat of terrorism seriously, it is selective in its treatment of terrorist organizations and actors in South Asia.⁵⁷ According to two experts who testified to the Commission, China's growing concerns about terrorism in South Asia do not extend to anti-India terrorist groups. In 2015, for example, China defended Pakistan's decision to release Zaki-ur-Rehman Lakhvi—a commander of a Pakistani anti-India terrorist group Lashkar-e-Taiba—who had been

*For a comprehensive assessment of China's terrorism challenge and its response, see Murray Scot Tanner and James Bellacqua, “China's Response to Terrorism,” *CNA* (prepared for the U.S.-China Economic and Security Review Commission), June 2016.

†Xinjiang shares a border with Afghanistan, India (claimed), Kazakhstan, Kyrgyzstan, Mongolia, Pakistan, Russia, and Tajikistan. For a discussion of the role terrorism plays in China's relations with Central Asia in particular, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 393–395, 406–410.

‡For more on the Shanghai Cooperation Organization, and China-Central Asia relations more broadly, see U.S.-China Economic and Security Review Commission, in *2015 Annual Report to Congress*, November 2015, 391–427.

imprisoned for his suspected role in planning the 2008 Mumbai terrorist attack that killed more than 160 people.⁵⁸ At the same time, China's history of committing domestic human rights abuses in the name of counterterrorism⁵⁹ and the Shanghai Cooperation Organization's failure to meet UN standards for human rights protection⁶⁰ raise questions about China's efforts to address terrorism in South Asia. According to Human Rights Watch:

It's understandable that China, Pakistan and Tajikistan all fear the spillover security effects of the continuing war in Afghanistan. But [China's] rhetoric about how they should collaborate to "fight terrorism" is effectively code for imposing repressive security measures and clamping down on domestic dissent—in other words, the same strategy China has pursued in Xinjiang. ... China, Pakistan and Tajikistan do not provide the model Afghanistan needs to address the growing Taliban threat while upholding fundamental rights.⁶¹

(For more on China's counterterrorism engagement with Pakistan and Afghanistan, see "Pakistan, China, and Terrorism" and "Afghanistan," later in this section.)

China-India Relations

In general, China and India have maintained cordial relations in recent decades, and the likelihood of conflict between the two—either at the border or in the Indian Ocean—is low.⁶² Tensions in the relationship are driven primarily by China's longstanding support for Pakistan (discussed later), Tibet and the border dispute, and to a lesser extent by growing distrust and competition in the Indian Ocean and by economic imbalances. Taken together, these various features of China-India relations have led many to perceive that China is pursuing a strategy of containment or encirclement of India, according to several experts with whom the Commission met in India.⁶³ For its part, China perceives India's growing ties with the United States—discussed later—as part of a U.S.-led effort to contain or encircle China.⁶⁴ As a result, both countries are deeply suspicious of each other.

Tibet and the Dalai Lama

Tibet has been a persistent irritant in China-India relations since 1951, when the People's Republic of China took control of Tibet. Tensions escalated in 1959 when the Dalai Lama fled from the Tibetan capital of Lhasa to India in the midst of a popular rebellion and PLA crackdown.⁶⁵ These events transformed Tibet from a strategic buffer to a lasting flashpoint in China-India relations.

The Chinese government perceives Delhi's decades-long willingness to host the Dalai Lama and the Tibetan Government in Exile in Dharamsala as an affront to China's sovereignty and evidence of nefarious intentions toward China.⁶⁶ As part of a larger effort to discredit the Dalai Lama, Beijing requests that Delhi prevent the Dalai Lama from engaging in "political activities" in India. Although neither government has defined "political activities," Indian leaders nevertheless have generally taken care over the decades to exert some control over the ac-

tivities of the Dalai Lama and the Tibetan refugee community out of sensitivity to Beijing (for example, Indian officials are not allowed to appear publicly with the Dalai Lama, and there are restrictions on Tibetan refugees' ability to participate in political activities like protests).⁶⁷ Indian government officials have also reiterated the Indian government's stance that Tibet is part of China.⁶⁸ It is clear to both sides, however, that India wields leverage over China when it comes to Tibet and that India could play "the Tibet card" against China if necessary⁶⁹—for example, by stirring dissent among Tibetans in the disputed border region.⁷⁰ According to Jeff Smith, director of Asian Security Programs and Kraemer security fellow at the American Foreign Policy Council, although India historically has hesitated to rely on this point of leverage, "there are signs that if the Sino-Indian competition continues to sharpen in the decades ahead, Delhi may increasingly look to Tibet to balance perceived Chinese aggression."⁷¹

The influence the Dalai Lama heretofore has wielded over the political status of Tibet, the culture of Tibetan communities inside and outside Tibet, and the extent of India's leverage over China will become an increasingly urgent consideration in the coming years. The Dalai Lama is 81 years old, and the politically fraught problem of his reincarnation looms. He has not indicated how the next Dalai Lama will be identified, although the Chinese government has already indicated it will choose his successor. Since the 1990s, the Chinese government has made efforts to increase its influence and control over Tibetan Buddhism by claiming a role in the reincarnation process. In 1995, shortly after the Dalai Lama selected the Panchen Lama, the second-highest-ranking figure in Tibetan Buddhism, the Chinese government kidnapped and detained the 6-year-old Panchen Lama and hand-picked its own replacement; the whereabouts of the Dalai Lama's designated Panchen Lama have been unknown since then.⁷² In 2007, the Chinese government began implementing laws requiring government approval for reincarnation.⁷³ In 2011, the Dalai Lama suggested he might not reincarnate at all but rather emanate, a Tibetan succession method that involves the designation of a lama's successor while the current lama is still alive. In his statement, he acknowledged "there is an obvious risk of vested political interests misusing the reincarnation system to fulfil their own political agenda. Therefore, while I remain physically and mentally fit, it seems important to me that we draw up clear guidelines to recognize the next Dalai Lama, so that there is no room for doubt or deception."⁷⁴ In a 2014 BBC interview, he suggested he may be the last Dalai Lama, saying, "The Dalai Lama institution will cease one day. These man-made institutions will cease."⁷⁵

The confluence of several factors—including China's insecurities about Tibet and its resultant heavy-handed policies there, the unusual geographic and political circumstances of a major religious succession in exile, the current Dalai Lama's worldwide popularity, and Tibetan Buddhism's unique reputation in the world's collective imagination—suggest the transition will not be smooth. The succession process is complicated further by the fact that in 2011, the Dalai Lama voluntarily renounced the political authority of his position to the office of the prime minister of the Tibetan Government in Exile, ending a 400-year tradition in which the Dalai Lama was

both the spiritual and political leader of the Tibetan people in favor of a more democratic process. The current prime minister of the Tibetan Government in Exile, Lobsang Sangay, referred to this shift as an opportunity as well as a challenge as to “whether we can rally around a system and a principle, rather than the cult of a leader.”⁷⁶

In addition to having potentially far-reaching implications for the future of Tibetan Buddhism, Tibetan identity, and Tibet’s political status in China, the transition from the current Dalai Lama’s leadership may impact China-India relations significantly.⁷⁷ Even if the transition is managed smoothly, the balance of power between China and India likely will shift depending on the outcome. If the Dalai Lama selects a successor in India, Delhi may find its existing leverage over China sustains or increases. Conversely, Delhi’s leverage could decrease if Beijing succeeds in appointing a pro-China successor in China and discrediting the Dalai Lama’s chosen successor. India might also have to contend with challenges such as the exacerbation of emergent political divisions in its Tibetan refugee communities (potentially to include the rise of more vocal pro-independence constituencies). Should the Dalai Lama select a successor from a disputed area along the China-India border (such as Tawang, a small but famous Buddhist enclave claimed by China but controlled by India, where the sixth Dalai Lama was born), the border dispute could intensify.⁷⁸

Also of note, Chinese President and General Secretary of the Chinese Communist Party Xi Jinping’s recently announced military reforms will impact China’s military posture in Tibet. The reforms included the dismantling of the PLA’s former military regions and the establishment of a joint theater command structure with a regional combat orientation. One of these new theater commands is the Western Theater Command, which is focused in part on missions related to Tibet and the Indian border dispute.⁷⁹ One scholar with whom the Commission met in China noted that India is concerned that China’s development of rail infrastructure on the Tibetan Plateau would allow it to deploy troops to the region more quickly.⁸⁰ China’s road and rail infrastructure on the Tibetan side of the border is much more robust and reliable than that on the Indian side, allowing China to more quickly deploy personnel, materiel, and weapons in a contingency.⁸¹

The Border Dispute

The border dispute remains the most likely source of armed conflict between China and India, although the probability of such a confrontation is low, particularly if other facets of the relationship are relatively calm.⁸² As noted previously, Tibet served as a buffer between China and India until the 1950s, when China’s invasion of Tibet “shrank the strategic distance” between the two countries, according to Srinath Raghavan, senior fellow at the Centre for Policy Research in New Delhi.⁸³ The PLA launched a surprise invasion across the border in 1962, winning decisively in 32 days; although there were no major border clashes after 1967, hostility continued until the two countries restored diplomatic relations in 1976. More recently, the dispute is characterized by diplomatic sparring, the buildup and occasional movement of troops, and regular claims of

incursions across the border from both sides⁸⁴ (India claimed 334 “transgressions” by Chinese border troops in the first nine months of 2014,⁸⁵ for example).

Geographically, the border dispute spans several sections of the two countries’ 2,500-mile-long border (see Figure 5). The Western Sector (Aksai Chin) refers to a 14,670-square-mile area that China has occupied since the 1962 war but which India claims as part of the state of Jammu and Kashmir (which in turn is contested by Pakistan), and a 580-square-mile area controlled by India but which China claims. The Middle Sector refers to several small pockets of disputed territory, as well as Sikkim, which is controlled by India but which China has claimed with varying degrees of resolve over time. The Eastern Sector, a 34,700-square-mile area controlled by India (which refers to it as the state of Arunachal Pradesh), is the most volatile and strategically significant section of the contested border due to its large population and rich resources, and because it is home to the town of Tawang.*⁸⁶

Figure 5: China-India Border Dispute



Note: Areas claimed by China but occupied by India are noted in black; areas claimed by India but occupied by China are noted in white.

Source: Adapted from Jeff Smith, *Cold Peace: China-India Rivalry in the Twenty-First Century*, Lexington Books, 2014, 23.

In 1981, China and India began border talks, and more than 30 rounds of negotiations and related meetings have been held to date.⁸⁷ Overall, little progress has been made on resolving the

*Technically not part of the China-India border dispute, the 2,000-square-mile Shaksgam Valley was ceded to China by Pakistan in 1963, although India claims it and maintains that Pakistan did not have the authority to cede the territory. Jeff Smith, *Cold Peace: Sino-Indian Rivalry in the Twenty-First Century*, Lexington Books, 2014, 24–25.

dispute, and there are few signs of a breakthrough in negotiations in the near to medium term.⁸⁸ In fact, Mr. Smith argues that “domestic constraints are likely to materially restrict the ability of the leadership in Beijing and Delhi to make territorial concessions in the future,” suggesting “the window to reaching a border resolution may be closing.”⁸⁹ Nevertheless, the border talks have built valuable resiliency and predictability into the two countries’ relations. Some of the practical notable accomplishments of the negotiations have been the establishment of confidence-building measures and the de-linking of the border dispute from the broader diplomatic relationship.⁹⁰ These confidence-building measures, announced in 1996, include requirements such as reducing the number of military forces and armaments in specific areas near the border, avoiding large-scale military exercises close to the border, restricting flights of combat aircraft near the border, and sharing information about military presence and activities near the border. Subsequent agreements, such as the 2013 Border Defence Cooperation Agreement, have expanded these kinds of measures.⁹¹

China, with its fairly robust military infrastructure and troop presence in Tibet, historically has been in a more militarily advantageous position along the border than has India.⁹² In the mid-2000s, however, the Indian government began an extended effort to upgrade and enhance access to the border and initiated a troop buildup on the Indian side.⁹³ Observers disagree whether this will ultimately build stability into the border dispute, or invite confrontation.⁹⁴

China-India Tensions over the Brahmaputra River

All of China’s major rivers (including three of the world’s five largest rivers measured by discharge) originate in the Tibetan plateau.⁹⁵ One of these rivers, the Brahmaputra, flows from China through India and Bangladesh; the river is important for irrigation and transportation and affects the lives of more than 100 million people. It is also a source of tension between China and India. India fears China—which has a history of damming and diverting water from transboundary rivers without consulting downstream countries⁹⁶—will disrupt the flow of the river, and some Indians have suggested China might seek to use its control over the river as leverage in a future conflict with India.⁹⁷ In recent years, China has assuaged India’s concerns somewhat by signing agreements to share hydrological data. For its part, China is concerned that India’s planned construction of dams in the disputed territory of Arunachal Pradesh is enabling India to consolidate its de facto control over the area.⁹⁸

Rising Competition in the Indian Ocean

As noted earlier, China seeks greater presence and influence in the Indian Ocean region, primarily to protect the sea lines of communication upon which its economy depends,⁹⁹ as well as to expand its influence. China will have to depend on the stability and goodwill of South Asian countries to ensure a peaceful maritime environment

conducive to sea lane protection, and much of Beijing's diplomatic efforts in the region are designed to cultivate such an environment. In addition to pursuing access through diplomacy, China is enhancing the PLA's ability to operate and protect Chinese interests in the Indian Ocean. The following developments point to China's growing military presence in the Indian Ocean:

- *China's 2015 defense white paper signals a shift to maritime security and sea lane protection:* China's 2015 defense white paper, *China's Military Strategy*, decisively elevates the maritime domain in China's strategic thinking, asserting that "the traditional mentality that land outweighs sea must be abandoned." Although the Indian Ocean was not mentioned, the paper notes China will increasingly shift from focusing exclusively on its near seas to a "combination of 'offshore waters defense' with 'open seas protection.'"¹⁰⁰
- *China's antipiracy patrols in the Gulf of Aden:* The PLA Navy has maintained a near-continuous presence in the Indian Ocean for seven years since it began conducting antipiracy patrols, and has made significant contributions to the international effort to eradicate piracy in the region. Although piracy in the Gulf of Aden has declined significantly in recent years due to the success of international antipiracy efforts, the PLA Navy has not indicated it will conclude operations there. Dr. Brewster testified to the Commission that "Beijing is now using its antipiracy deployments as justification for expanding its naval presence in the Indian Ocean and making it more permanent."¹⁰¹
- *Chinese submarine deployments:* The PLA has conducted at least four submarine patrols in the Indian Ocean since 2013. Chinese officials claim these submarines support China's antipiracy activities. The more likely purpose of these deployments is to collect intelligence on U.S., Indian, and other forces in the Indian Ocean; test and enhance the ability of China's submarine crews to operate for long durations at extended distances from mainland China; prepare for potential crises and wartime operations in the Indian Ocean; and demonstrate China's growing interests in the region.¹⁰²
- *China's military logistics facility in Djibouti:* In 2015, China announced it would establish its first overseas military logistics facility in Djibouti.¹⁰³ The facility, for which Chinese company China Merchant Holding International holds a ten-year lease, will augment the PLA Navy's existing presence in the region with replenishment and repair services. For more information on recent developments regarding the Djibouti facility, see Chapter 2, Section 1, "Year in Review: Security and Foreign Affairs."

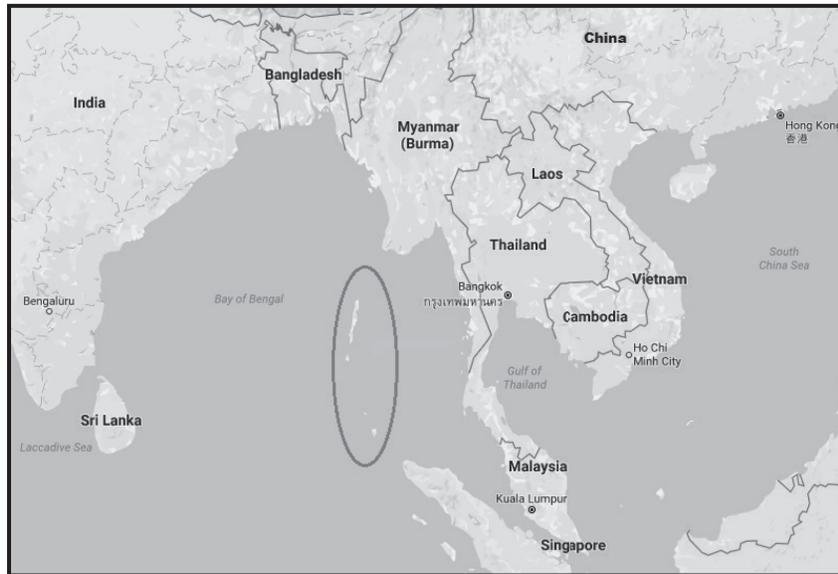
Predictably, these developments cause anxiety in India, which already struggles to maintain parity with the Chinese military across the contested land border.¹⁰⁴ In addition to Indian interlocutors who spoke of Chinese "encirclement" or "containment" of India, one expert told the Commission that India worries China's recent aggres-

siveness in the South China Sea may manifest in its conduct in the Indian Ocean as its presence grows there.¹⁰⁵ Currently, India remains the dominant military power in the Indian Ocean, and India “takes a fairly proprietary view of the Indian Ocean,” according to Dr. Brewster’s testimony to the Commission. He elaborates, saying, “India aspires to be recognized as the leading naval power in the Indian Ocean in the long term, and many Indian analysts and decision-makers have a strong instinctive reaction against the presence of extra-regional powers in the Indian Ocean, essentially seeing such presence as unnecessary and even illegitimate.”¹⁰⁶ Beside security, India has a compelling economic reason for protecting its access to the Indian Ocean: India shares a land border with only one of its top 25 trade partners (China), with most of its trade, including energy imports, coming across the sea.¹⁰⁷ As a result, the Indian Ocean is likely to become an area of increasing competition between China and India. Early indicators suggest this competition will manifest in the following ways:

- *Greater emphasis on naval modernization in India:* Indian naval modernization has been ongoing since the mid-1980s, but progress has been slow. The recent uptick in Chinese naval activities in the Indian Ocean has accelerated this process, however, “[leading] the Indian Navy to effectively ‘rebalance’ its fleet from its Western Fleet facing Pakistan, towards its Eastern Fleet facing China,” according to Dr. Brewster.¹⁰⁸ In particular, the Indian Navy is seeking to enhance its position at the strategically located Andaman and Nicobar Island chain (see Figure 6), which stretches almost 400 nautical miles at the western end of the Strait of Malacca. It is increasing its intelligence, surveillance, and reconnaissance capabilities there with the deployment of P-8I Poseidon reconnaissance aircraft and expanding its naval and air infrastructure in several locations along the island chain.¹⁰⁹ Additionally, over the next decade, the Indian Navy plans to expand its power projection capabilities with more aircraft carriers, major surface combatants, diesel and nuclear-powered submarines, fighter aircraft, helicopters, and long-range surveillance aircraft.¹¹⁰
- *Growing Chinese naval presence in the region:* In addition to antipiracy patrols and activities out of China’s new facility in Djibouti, the PLA Navy can be expected to continue deploying submarines to and conducting combat readiness patrols in the Indian Ocean.
- *Competitive military diplomacy in the region:* As China seeks access and influence in the region, and as India seeks to reinforce its own, both countries can be expected to use military diplomacy—from arms sales to joint training and other incentives for cooperation—to further their interests. India is stepping up its maritime aid to countries like Mauritius and the Maldives,¹¹¹ while China has provided military technology to Bangladesh, Burma, the Maldives, Pakistan, and Sri Lanka.¹¹² As noted earlier, China has invested in maritime infrastructure throughout the region, including in places like Gwadar Port and

Karachi Port, that could eventually enable Chinese naval access to these areas.¹¹³

Figure 6: India's Andaman and Nicobar Island Chain



Source: Google Maps.

For the time being, India enjoys a significant advantage over China in the Indian Ocean: its influence over Indian Ocean states outweighs that of China, and more importantly, it enjoys a geographic advantage while China suffers from the “tyranny of distance.” According to Dr. Brewster, “China’s ability to project significant power in to the Indian Ocean remains highly constrained by the long distance from Chinese ports and air bases, the lack of logistical support, and the need for Chinese naval vessels to deploy to the Indian Ocean through chokepoints.”¹¹⁴

The nature of Sino-Indian competition in the Indian Ocean currently is fairly low-intensity, for a couple of reasons. First, China’s primary security interests still reside in the Western Pacific, with Taiwan and maritime disputes in the East and South China seas being Beijing’s (and the PLA’s) top priorities.¹¹⁵ China’s preoccupation with these areas, combined with the PLA Navy’s limited (albeit growing) ability to sustain a robust presence far from China’s shores, will limit its influence and capabilities in the Indian Ocean for now.¹¹⁶ Second, China’s primary interest in the Indian Ocean—sea lane security—does not in and of itself pose a threat to or challenge the interests of other countries (in contrast to China’s efforts to advance its maritime claims in its near seas). However, China’s recent record of flouting international norms and laws and employing bullying tactics against weaker states to advance its interests—particularly in the maritime realm—throws doubt on this

assumption, and likely will cause India and other countries to be suspicious of China's real intentions in the Indian Ocean.

Economic Tensions

Sino-Indian economic competition, security tensions, and India's wariness of China's expanding influence in the region contribute to the relative weakness of economic ties between the two Asian giants, but the two countries do cooperate, especially on the multilateral front. India is the second-largest shareholder in the China-led Asian Infrastructure Investment Bank and a cofounder (with other BRICS* countries) of the New Development Bank. India and China are not members of the U.S.-led Trans-Pacific Partnership (TPP), but are parties to the China-led Regional Comprehensive Economic Partnership (RCEP), a "mega-regional" agreement currently being negotiated by the ten members of ASEAN and six major economies in the Asia Pacific (for further discussion of TPP and RCEP, see Chapter 4, "China and the U.S. Rebalance to Asia").

India wants to attract Chinese investment. Prime Minister Modi's "Make in India" initiative is aimed at boosting Indian manufacturing capability and attracting capital investment, in large part from China.¹¹⁷ India also seeks to sell more to China, with which it runs a persistent trade deficit (reaching over \$50 billion, or 2 percent of India's GDP, in 2015).¹¹⁸ To facilitate economic exchanges, India and China have established a Strategic Economic Dialogue, a Joint Economic Group, and a Financial Dialogue; there are also plans for a new dialogue between India's Department of Economic Affairs and China's Development Research Center of the State Council.¹¹⁹

Realizing enhanced economic cooperation will not be easy. While China is India's top source of imports and third-largest export market (after the United States and United Arab Emirates), India is a minor trade partner for China (accounting for 2 percent of China's exports and 1 percent of imports in 2014).¹²⁰ Several factors contribute to this imbalanced relationship; chief among them is India's growing imports of Chinese manufactured goods, which sharply contrasts with China's tepid interest in India's main exports—agriculture and services.¹²¹ During the Commission's trip to India, Indian business representatives and think tank scholars noted that growing imports from China are displacing local producers and hurting India's manufacturing industry.¹²² Responding to rising concerns, in 2015 and 2016 India's government imposed import restraints on select products from China, including steel, mobile phones, and milk.¹²³ Security suspicions continue to undermine deeper engagement: according to one report, when President Xi visited India in 2014, he intended to announce investment deals worth \$100 billion, but ended up promising only \$20 billion after a border standoff between Indian and Chinese soldiers began days before the visit.¹²⁴ Chinese border incursions have coincided with major bilateral meetings in the past;¹²⁵ on this occasion, 1,000 troops from each side were locked in an "eyeball-to-eyeball confrontation" after China advanced across the temporary border, according to an Indian media report.¹²⁶

*BRICS refers to the informal grouping of emerging economies Brazil, Russia, India, China, and South Africa.

India and OBOR

India has not endorsed China's OBOR initiative, which it views with suspicion. Tanvi Madan, director of the India Project at the Brookings Institution, testified to the Commission that many Indian policymakers disapprove of Beijing's "unilateralist" approach to OBOR.¹²⁷ Indian Foreign Secretary S. Jaishankar described OBOR as a "national initiative devised with national interest," noting, "The Chinese devised it, created a blueprint. It wasn't an international initiative they discussed with the whole world, with countries that are interested or affected by it."¹²⁸

Scholars and analysts who met with the Commission in India emphasized that India's government is particularly troubled by the China-Pakistan Economic Corridor (CPEC), the centerpiece of China's OBOR initiative in South Asia.¹²⁹ In June 2015, India declared that CPEC was "not acceptable" because it would pass through the territory India claims in the disputed Kashmir region.¹³⁰ Analysts at the Observer Research Foundation, an Indian think tank, said, "A formal nod to [CPEC] will serve as a de facto legitimization to Pakistan's rights on Pakistan-occupied Kashmir."¹³¹ (For a more detailed discussion of CPEC, see "China-Pakistan Economic Corridor," later in this section.) At the same time, India is investing in alternative connectivity frameworks that circumvent China and Pakistan. In May 2016, India signed an agreement to develop a transport corridor between Afghanistan and Iran, anchored at the Iranian port of Chabahar, which is located across the border from Pakistan's Chinese-backed Gwadar Port.¹³² Indian interlocutors told the Commission that India is pursuing the port deal with Iran in part to mitigate the security and economic challenges India might face from China's OBOR projects, and from CPEC in particular.¹³³

India's approach to OBOR is complicated, however, by its tentative endorsement of the Bangladesh-China-India-Myanmar (BCIM) economic corridor, a project that predates OBOR, but which the Chinese government has since tried to integrate as the southwestern route of the initiative.¹³⁴ BCIM would link Kolkata (India) with Kunming (the capital of China's Yunnan Province) by high-speed rail and other infrastructure, passing through Burma and Bangladesh.¹³⁵ On the one hand, BCIM presents an attractive prospect for India because it will "cross horizontally through India's underdeveloped northeastern states, a region Prime Minister Modi has targeted as a priority for development," according to Mr. Smith.¹³⁶ On the other hand, interlocutors who met with the Commission in Beijing and New Delhi noted India is wary of having China-led projects "at its front door."¹³⁷ On the security side, India fears China's presence on its border—for example, to protect Chinese workers; on the economic side, there are worries BCIM will flood India with Chinese-made products, which will compete with domestically produced goods.

China-Pakistan Relations

China's relationship with Pakistan has been uniquely close (although the two are not formal allies) since the early 1960s when China-India relations began to unravel. Officials from both countries term China and Pakistan "all-weather friends,"¹³⁸ and Pakistani officials often describe Sino-Pakistani friendship as "higher than mountains, deeper than oceans, and sweeter than honey."¹³⁹ Security relations, particularly as they relate to India, are at the heart of Sino-Pakistani ties, although in the past two years economic cooperation has come to the fore with the establishment of CPEC. At the same time, as China's interests in Afghanistan have expanded, so has its engagement with Pakistan on issues related to Afghanistan's security and the wider threat of terrorism in the region. The following are key facets of the relationship.

Bolstering Pakistan's Defense vis-à-vis India

As previously noted, China's support for Pakistan is driven in large part by shared concerns about India: for China, India represents a potential challenge to China's regional dominance. For Pakistan, India represents the country's top security threat, a perception informed by their history of partition, four wars, territorial disputes, terrorism, and overall deep-seated distrust.¹⁴⁰ Mr. Small summarized this longstanding dynamic in testimony to the Commission, saying, "China benefitted from Pakistan's role as a counter-balance to India, while Pakistan benefitted from China's willingness to provide the capabilities it needed to do so effectively."¹⁴¹ Although China has never intervened in an India-Pakistan conflict on Pakistan's behalf, its diplomatic, material, training, and intelligence support have enabled Pakistan to present a formidable military challenge to India.¹⁴² This support drives India's concerns about having to face a "two-front war" with both Pakistan and China.¹⁴³

China's Arms Sales to Pakistan

China, now the world's third-largest supplier of arms, exports more to Pakistan than to any other country, according to the Stockholm International Peace Research Institute (SIPRI).¹⁴⁴ China was instrumental in enabling Pakistan's indigenous ballistic missile capability in the 1980s and 1990s (even in the face of U.S. sanctions), and China's generosity in military cooperation reached its zenith when Beijing assisted Islamabad in building its first nuclear bomb. Beijing's assistance with Pakistan's nuclear program continues today, though mostly in the civilian sphere.¹⁴⁵ And although China's military assistance over these years had a game-changing effect on Pakistan's military capabilities, many of the conventional military items Beijing provided were fairly rudimentary.

More recently, according to Mr. Small, "As the PLA's technical capabilities improve, Pakistan is becoming one of the principal beneficiaries of these advances."¹⁴⁶ SIPRI data show Pakistan received 35 percent of China's arms exports in the period from 2011 to 2015. Arms transferred (or, in some cases, licensed) by China

China's Arms Sales to Pakistan—Continued

to Pakistan since 2014 have included antiship missiles, torpedoes, combat helicopters, a surface-to-air missile system, a patrol vessel, and most recently, eight air independent propulsion equipped diesel-electric submarines (half of which will be built in China; the other half will be built in Pakistan).¹⁴⁷ Pakistan's first armed unmanned aerial vehicle, which conducted its first acknowledged operational strike in 2015, also appears to have been produced with China's cooperation.¹⁴⁸

In 2016, *IHS Jane's* reported that Pakistan appears to have taken delivery of two Chinese transporter erector launchers for its new Shaheen-III medium-range ballistic missile, allegedly conventional- and nuclear-capable with a range of 2,750 kilometers (1,700 miles). Transporter erector launchers are designated items covered by the Missile Technology Control Regime, which China is not party to, but which it has applied to join and pledged to abide by.*¹⁴⁹

The Sino-Pakistani defense relationship has left Islamabad greatly indebted to Beijing,¹⁵⁰ although it benefits Beijing as well. In addition to ensuring that India will always be too preoccupied with its ongoing rivalry with Pakistan to devote sufficient strategic energy and resources to countering China, Islamabad on occasion has offered China more concrete benefits, including access to advanced U.S. arms. For example, unexploded U.S. Tomahawk cruise missiles used in Afghanistan in the 1990s were acquired by the Pakistani military and passed to the PLA; reverse-engineered cruise missiles began appearing in Pakistani and Chinese arsenals shortly thereafter.¹⁵¹ In 2011, Pakistan allowed Chinese analysts to examine the U.S. stealth helicopter that crashed in Abbottabad during the Osama Bin Laden raid.¹⁵²

China's support for Pakistan's defense has its limits. Beijing values Pakistan's ability to act as a check on Indian power, but it also values stability in the region and thus is uninterested in enabling or encouraging Pakistan to instigate a major confrontation with India.† Beijing's decision to provide Pakistan with the means to develop nuclear weapons would seem to contradict this, although Chinese officials would argue that helping Pakistan develop the bomb would create parity and strategic stability with India.¹⁵³ In 1975, at the height of China's cooperation on Pakistan's nuclear program and one year after India's first successful nuclear test, China's soon-to-be leader Deng Xiaoping remarked that China does "not advocate for nuclear proliferation at all, but we even more strongly oppose nuclear monopolies."¹⁵⁴ As discussed

*The Missile Technology Control Regime is a nontreaty association of 35 countries including the United States that aims to control the proliferation of missiles and related technologies. Member countries are to "exercise restraint in the consideration of all transfers" of designated items. Missile Technology Control Regime, "Missile Technology Control Regime (MTCR) Annex Handbook – 2010," 2010, 12.

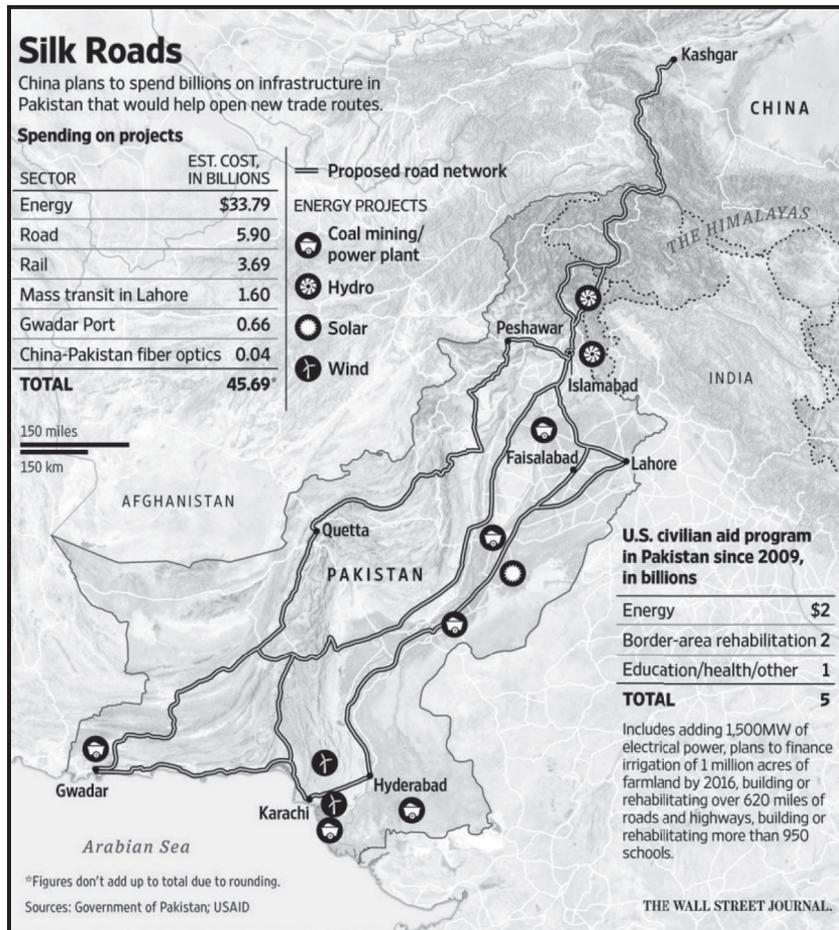
†This was the case as far back as the 1971 war between Pakistan and India when, to Islamabad's disappointment, China declined to intervene in the war on Pakistan's behalf. Again in 1999, Chinese officials emphasized to their counterparts in Islamabad that China would not support Pakistan in an ongoing conflict over the India-Pakistan border. Andrew Small, *The China-Pakistan Axis: Asia's New Geopolitics*, Oxford University Press, 2015, 14–16, 56–57, 59–61; Jeff Smith, *Cold Peace: China-India Rivalry in the Twenty-First Century*, Lexington Books, 2014, 131.

later, China’s enabling of Pakistan’s nuclear program could yet have major implications for regional stability, particularly if Pakistan’s nuclear weapons were to fall into the hands terrorists or rogue elements of the defense establishment.¹⁵⁵

China-Pakistan Economic Corridor

China’s commitment to Pakistan has always been strategic in nature, driven by their mutual rivalry with India, with the economic dimension of the relationship lagging. Although China is Pakistan’s top source of imports and second-largest export market (after the United States), the amounts involved account for a negligible portion of China’s trade (\$9.2 billion in exports and \$2.7 billion of imports in 2014).¹⁵⁶ The potential game-changer for Pakistan is the \$46 billion CPEC (see Figure 7).

Figure 7: CPEC in Detail



Source: Saeed Shah and Jeremy Page, “China Readies \$46 Billion for Pakistan Trade Route,” *Wall Street Journal*, April 16, 2015.

For China, the goals of CPEC are threefold. First, China seeks to create an alternative trade route through Pakistan to facilitate the transit of its energy imports from the Middle East and exports of its goods to the Middle East, Africa, and Europe. As in the case of China's engagement with Central Asian states, the overland route taken by CPEC may allow China to reduce its reliance on energy shipments through vulnerable chokepoints in the Indian Ocean and South China Sea (the so-called "Malacca Dilemma").¹⁵⁷ Second, through economic development, China hopes to counter Islamic terrorism and extremism in Xinjiang, and in Pakistan and Afghanistan.¹⁵⁸ Finally, China hopes the investment will support Pakistan, which has been struggling with unstable economic and security environments.¹⁵⁹

In many ways, CPEC is the most well-articulated project under the OBOR umbrella, primarily because factors driving China's deeper economic engagement with Pakistan—in particular the need to stabilize its western border—predate OBOR and CPEC. As Mr. Small noted in his testimony, under President Xi, "China has also more actively sought to use economic tools as means to achieve regional stability, including in Pakistan itself."¹⁶⁰

Although China's OBOR projects usually involve construction of transportation corridors—and CPEC does include a number of such projects*—CPEC's main emphasis is on energy projects, to which nearly \$34 billion of the proposed investment is dedicated.¹⁶¹ This makes it especially important for Pakistan, which suffers from chronic energy shortages; the shortfall was estimated at 4,500 megawatts (MW) in 2015.¹⁶² In January 2016, China and Pakistan broke ground on the \$1.65 billion Karot hydropower plant, a flagship CPEC energy project. Other projects include the construction of the world's largest solar power plant in Punjab Province and a coal power plant in Port Quasim. All told, China plans 21 energy projects in Pakistan, which would provide an additional 16,400 MW of energy, roughly equivalent to Pakistan's current capacity.¹⁶³

Despite high-level bilateral commitment to the project from China and Pakistan, CPEC faces a number of challenges, including domestic opposition from provinces along CPEC and significant security concerns:¹⁶⁴

- *Territorial disputes:* CPEC's gateway from China to Pakistan is in Gilgit-Baltistan, which is part of Jammu and Kashmir, a territory claimed by both India and Pakistan. India views China's activities in Kashmir as a security challenge, and has launched an official protest, declaring CPEC "unacceptable."¹⁶⁵
- *Insurgency threats:* CPEC will also have projects in the provinces of Khyber Pakhtunkhwa and Balochistan, both of which are plagued by militancy, separatism, and rampant human rights abuse by the military. Pakistan says it will establish a special security division of Pakistani guards to protect Chinese workers there. According to Chinese government scholars who met with the Commission in Beijing, Pakistan will provide a

*Pakistan's government announced three new highway routes and construction or upgrading of existing railways, as well as a cross-border optical cable project. Board of Investment, Prime Minister's Office Government of Pakistan, *China Pakistan Economic Corridor (CPEC)*, January 13, 2016. <http://boi.gov.pk/ViewNews.aspx?NID=%20892>.

20,000-strong security force, including 10,000 police and 10,000 military troops.¹⁶⁶

- *Corruption*: Pakistan has a history of awarding projects to those in political favor. Already, the governments of Khyber Pakhtunkhwa and Balochistan have complained that their concerns about CPEC routes and resource allocation were being ignored.¹⁶⁷
- *Human rights abuses*: Pakistani military forces tasked with protecting CPEC projects in Gilgit-Baltistan and Balochistan reportedly displaced citizens from areas designated for projects, and cracked down on local dissent over CPEC.¹⁶⁸

Even if CPEC is realized successfully, questions remain about its ability to satisfy China's priorities. For example, in his testimony before the Commission, Daniel S. Markey, adjunct senior fellow for India, Pakistan, and South Asia at the Council on Foreign Relations, expressed reservations about CPEC's ability to help solve China's Malacca Dilemma, noting:

*The terrain through Pakistan and over the Himalayas into western China is some of the most difficult in the world. Pipelines through restive Balochistan can hardly be considered more secure than the maritime tanker trade, and the sheer volume of China's energy demand—projected to double U.S. energy consumption by 2040—could not be slaked by this route, even if China follows through on every penny of the promised investments in Pakistan's port and transit infrastructure.*¹⁶⁹

More importantly, there is no guarantee that China's investments into Pakistan's economy will address China's fears of growing terrorist and separatist threats on its western periphery.

Pakistan, China, and Terrorism

Some manifestations of extremism, militancy, and terrorism in China have roots in Pakistan. Groups such as the East Turkestan Islamic Movement (ETIM)* and the Islamic Movement of Uzbekistan have Uyghur membership, are designated terrorist organizations by the United States and the UN, and have been implicated in several terror plots or activities directed at China.†¹⁷⁰ They also have at some time been based in—or received support from groups in—Pakistan.¹⁷¹

As far back as the 1990s, China relied on its official contacts in Islamabad to apply pressure on militant Uyghur groups and their sponsors residing in Pakistan. The Pakistani military—and Pakistan's Inter-Services Intelligence (ISI) in particular—was well placed to play this role, given its ties to Pakistan's militant groups:

*ETIM's organization has at various points in its history been known as, or associated with, the Turkistan Islamic Party, the Turkistan Islamic Movement, and the East Turkestan Islamic Party. The location, leadership, and makeup of these groups have evolved, but in many ways they are one and the same.

†According to the Chinese government, "Incomplete statistics show that from 1990 to 2001, the 'East Turkestan' terrorist forces inside and outside Chinese territory were responsible for over 200 terrorist incidents in Xinjiang." The Chinese government has not updated this figure, nor has the figure been corroborated by other sources. China's Information Office of the State Council, 'East Turkestan' Terrorist Forces Cannot Get Away with Impunity, January 21, 2002.

according to Mr. Small, “The ISI used its influence to dissuade the groups that it sponsored from directing any of their energies towards China. It also facilitated meetings for Chinese officials and intelligence agents to strike deals with whomever they needed to in order to isolate the Uyghur militants from potential supporters among extremist organizations in Pakistan and Afghanistan.”¹⁷² At China’s behest, Pakistani officials would also crack down on Uyghur communities in Pakistan (whether or not there was legitimate evidence of terrorist activities in these communities) and attempt to prevent cross-border flows of militants, their arms, and their propaganda.¹⁷³

More recently, Beijing has not been able to count on Islamabad to contain ETIM and other militant groups targeting China. This has prompted an increasingly frustrated China to publicly implicate Pakistan in ETIM attacks on Chinese soil on several occasions.¹⁷⁴ Moreover, in the latter part of the 2000s, Pakistan was the most dangerous overseas location for Chinese citizens.¹⁷⁵ In times of desperation—such as in 2007 when several Chinese workers were kidnapped in a mosque in Pakistan and authorities in Islamabad seemed unable to extract them—Beijing bypassed diplomatic channels and liaised directly with militant contacts in the hopes of retrieving the hostages, who were later freed.¹⁷⁶

According to one expert, the inability or unwillingness of Islamabad to eradicate Pakistan-linked terror threats against Chinese targets is leading some Chinese analysts to conclude that the creeping “Islamization” of the Pakistani armed forces (particularly ISI) it has long supported is beginning to undermine China’s strategic interests. In his 2015 book on Sino-Pakistani relations, Mr. Small warns, “Inevitably, as the Pakistani state’s relationship with various militant organizations has fractured, its capacity to persuade them to steer clear of the Uyghurs’ cause has diminished. . . . These groups have been willing to make a specific target of China—especially its economic activities in Pakistan—if it helps to exert pressure on the Pakistani government. They certainly have not been deterred from affording protection to Uyghur militants.”¹⁷⁷ Assessing the links between Pakistan’s security apparatus and its terrorist groups and the implications of this relationship is beyond the scope of this Report. However, Pakistan’s apparent inability to address the seemingly minor challenge of neutralizing dozens of Uyghur militants raises other questions about the professionalism of Pakistan’s military, the security of Pakistan’s sophisticated array of weaponry,¹⁷⁸ and the wisdom of China’s past and continuing work with Pakistan in the nuclear realm.

Afghanistan

China has slowly expanded its diplomatic and security engagement with Afghanistan in recent years.* China’s recognition that it must shoulder greater responsibility in shaping Afghanistan’s future is driven by the following factors: First, China seeks to ensure Afghanistan does not provide a safe haven for extremists who might

*For a summary of China’s diplomatic and security engagement with Afghanistan through 2015, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 410–412.

target China.¹⁷⁹ Second, and relatedly, China fears the departure of the International Security Assistance Force from Afghanistan could leave the country in turmoil, potentially negatively impacting the security situations of neighboring countries, including China.¹⁸⁰ Third, Beijing seeks to create opportunities for Chinese companies to operate safely and profitably in Afghanistan; it also wants to spur investment and economic growth in Afghanistan, which it hopes will encourage greater stability and security in the country.*¹⁸¹

The most notable element of China's engagement with Afghanistan in 2016 was its involvement in the Quadrilateral Working Group. After laying the groundwork in 2015, China, the United States, Afghanistan, and Pakistan established the group in 2016 in an effort to start peace talks between the Afghan government and the Taliban,¹⁸² with which China has had longstanding, if unofficial, contact.† The Quadrilateral Working Group met several times in 2016, but so far has failed to convince the Taliban to enter negotiations, and it remains uncertain whether the group will emerge as a serious contributor to the peace and reconciliation process. Other examples of China's small but growing security outreach to Afghanistan include \$70 million in military aid pledged as of early 2016¹⁸³ and a proposal for a regional antiterror mechanism with Afghanistan, Pakistan, and Tajikistan—all countries that border Xinjiang. The details of the proposal are not clear, although Afghan President Ashraf Ghani has already endorsed it.¹⁸⁴

China's concerns about Pakistan's ability and willingness to eliminate ETIM and counter Islamic extremism more generally manifest in Afghanistan as well, where ISI has deep ties with the Taliban and other terrorist groups. One Chinese official has noted, "Pakistan's interests are still central to our Afghanistan policy but we don't see things the same way. ... They're more optimistic about the Taliban than we are, and more optimistic about controlling them. We're not so sure."¹⁸⁵

Implications for the United States

China's evolving relationship with South Asia, and its growing presence in the Indian Ocean, present an array of potential challenges and opportunities for the United States.

China-India Rivalry and U.S.-India Cooperation

Although the United States has had generally positive ties with India over the past several decades, significant ideological differences prevented a close partnership, including India's remaining out-

* China made initial investments in Afghanistan's natural resource sector, although these have stalled and show no signs of resuming in the near term. Frank Jack Daniel and Mirwais Harooni, "Chinese Demands, Rebels, and Buddhist Ruins Stall Afghan Copper Dream," Reuters, April 11, 2015.

† Before September 11, 2001, Beijing maintained good relations with the Afghan Taliban, offering engagement in exchange for the Taliban's promise that it would not provide cover or assistance to Chinese Uyghurs engaging in militant or extremist activities. Following the September 11 attacks and the start of the U.S. war in Afghanistan, China became more circumspect in its dealings with the Taliban, but it continued to quietly maintain ties. Now that reconciliation between Kabul and the Taliban is a stated priority for the Afghan government, China is reaching out as well, not least of all because it seeks a favorable position in the event the Taliban continues to be a major political player in Afghanistan. Andrew Small, *The China-Pakistan Axis: Asia's New Geopolitics*, Oxford University Press, 2015, 128; Andrew Small, "Why Is China Talking to the Taliban?" *Foreign Policy*, June 21, 2013; and U.S.-China Economic and Security Review Commission, *Hearing on China-Europe Relations*, oral testimony of Christina Lin, April 19, 2012.

side the Treaty on the Non-Proliferation of Nuclear Weapons* and its Cold War legacy of “nonalignment” (i.e., maintaining strategic autonomy).¹⁸⁶ It was not until the George W. Bush Administration that Washington sought significantly enhanced strategic ties with Delhi.¹⁸⁷ In many respects, U.S.-China tensions in the Asia Pacific and Sino-Indian rivalry in South Asia have nurtured a much closer relationship between the United States and India. According to Ashley Tellis, senior associate at the Carnegie Endowment for International Peace, “Indian interests and American interests fundamentally converge with respect to China. ... Obama understands China is really the big game the [United States] has to get right, and I think it’s in that context that the relationship in India is viewed today.”¹⁸⁸

The United States and India laid out a path of enhanced cooperation during President Barack Obama’s visit to India in January 2015, issuing a “Joint Strategic Vision for the Asia-Pacific and Indian Ocean Region” emphasizing cooperation in economics and security. Although it did not mention China or the OBOR initiative, the statement makes a commitment to accelerate regional economic integration “in a manner that links South, Southeast and Central Asia, including by enhancing energy transmission and encouraging free trade and greater people-to-people linkages.” The two sides affirmed “the importance of safeguarding maritime security and ensuring freedom of navigation and over flight throughout the region, especially in the South China Sea.” The United States also welcomed India’s interest in joining the Asia-Pacific Economic Cooperation forum.¹⁸⁹

The two countries built on this progress during President Modi’s June 2016 visit to Washington, DC, when they agreed to enhance defense technology sharing (including for aircraft carriers), begin a Maritime Security Dialogue, deepen cooperation on cybersecurity and outer space, and strengthen economic and trade ties, among other areas.¹⁹⁰ The United States named India a “Major Defense Partner” at this time as well, which commits the United States to working toward sharing defense technology with India “commensurate with that of [the United States]’ closest allies and partners” and the eventual provision of “license-free access to a wide range of dual-use technologies” to India.¹⁹¹ The Obama Administration has repeatedly said India is part of the U.S. Rebalance strategy, and the U.S. defense establishment has increasingly begun to use the term “Indo-Asia-Pacific” in statements and policy documents about the Rebalance and U.S. Asia policy more generally, suggesting U.S. policymakers are taking an increasingly holistic approach to East Asia and South Asia.

The U.S.-India economic relationship has never been particularly strong (in 2014, India accounted for only 1 percent of U.S. exports and 2 percent of U.S. imports).¹⁹² The two countries, however, are taking

* Because India has not signed the Treaty on the Non-Proliferation of Nuclear Weapons (NPT), it is excluded from the Nuclear Suppliers Group (NSG), which controls international trade in nuclear energy technology. In 2008, India received a special waiver from the NSG, granting it most benefits of membership, but India’s efforts to get full membership have not been successful. In June 2016, India’s most recent bid to join failed, in part due to opposition from several countries—such as Norway, New Zealand, South Africa, Brazil, and China—to granting membership to a nonsignatory of the NPT. India has singled out China as one of the most vocal countries opposing India’s membership, with India’s Foreign Minister Sushma Swaraj stating that China had created “procedural hurdles” by particularly questioning how a non-NPT signatory could become a member. Manu Balachandran, “China Has Foiled India’s Bid to Join the Nuclear Suppliers Group,” *Quartz*, June 24, 2016; *Indian Express*, “Centre Names China as Country Blocking India’s Entry into Nuclear Suppliers Group,” July 21, 2016.

steps to strengthen their trade and investment flows (for example, through the annual U.S.-India Strategic Dialogue, which has been expanded to include a commercial component, and a significant number of other dialogues, including the Trade Policy Forum and the U.S.-India Economic and Financial Partnership).¹⁹³ China's economic slowdown is also presenting an opportunity for India to attract U.S. and other foreign companies, since India's growth shows no signs of slowing down (it reportedly grew at 7.6 percent in 2015).¹⁹⁴ Despite these steps, U.S.-India trade faces significant obstacles, including disagreements at the World Trade Organization and India's own domestic economic constraints, including continued dominance of the state, limits on foreign investment, and bureaucratic inefficiency.¹⁹⁵

Meanwhile, the United States and India have been growing closer on issues related to the global commons. On Prime Minister Modi's second official visit to the United States in June 2016, he announced India's intention to formally join the Paris climate change agreement by the end of 2016—a coup for the Obama Administration, which has championed multilateral action on climate change.*¹⁹⁶ The two countries also announced several joint initiatives to finance clean energy development, including a \$20 million U.S.-India Clean Energy Finance initiative and a \$40 million U.S.-India Catalytic Solar Finance Program.¹⁹⁷

As China's influence and assertiveness in East Asia has grown in recent years, there has been much speculation over whether India would become part of a formal or informal coalition of countries that could cooperate in deterring the more destabilizing aspects of China's rise (namely, China's behavior in the South China Sea).¹⁹⁸ U.S.-India naval cooperation has expanded in recent years, particularly under Prime Minister Modi, and in March 2016, Commander of the U.S. Pacific Command Admiral Harry Harris proposed reestablishing the U.S.-India-Australia-Japan Quadrilateral Security Dialogue to “[support] the international rules-based order” in the region.¹⁹⁹ Whether India will be receptive to this is unclear. Earlier efforts to institutionalize such a quadrilateral failed, and while India's growing concerns about China's rise will continue to drive expanding U.S.-India defense ties, Delhi's nonalignment proclivities may preclude it from overtly challenging China (for example, by joining the U.S. Navy in a freedom of navigation operation in the South China Sea) in the near future.²⁰⁰ On the economic front, in a subtle counterpoint to China's OBOR, the U.S.-India-Japan Trilateral Ministerial dialogue promotes regional economic linkages, identifying “collaborative efforts that can help strengthen regional connectivity, including between South and Southeast Asia.”²⁰¹

Facets of U.S.-India Defense Relations

The U.S.-India defense relationship is “one of the biggest, fastest moving defense relationships in the world, period,” according to Frank Wisner, U.S. ambassador to India during the Bill Clinton Administration.²⁰² U.S.-India defense ties came to the forefront of the bilateral relationship in 2005, when the two countries signed

*India ratified the Paris climate change agreement on October 2, 2016. *Hindu* (India), “Paris Climate Pact to Enter into Force on Nov. 4,” October 6, 2016.

Facets of U.S.-India Defense Relations—Continued

their first formal defense agreement.* That ten-year agreement was renewed and expanded with another ten-year agreement in 2015.²⁰³ As noted earlier, in 2016, the United States formally recognized India as a “Major Defense Partner.”²⁰⁴ The following are some of the most notable areas of U.S.-India defense cooperation:

- *Military Exchanges and Exercises:* Bilateral and multilateral military exercises between the two countries have expanded in number and scope since the first U.S.-India military exercise in 1992;²⁰⁵ today, India conducts more annual military exercises with the United States than it does with any other country.²⁰⁶ Malabar, the flagship U.S.-India naval exercise that Japan permanently joined in 2015 after sporadic participation since 2007,[†] occurs annually and takes place alternately in the Indian Ocean and the Western Pacific. It aims to enhance interoperability and features complex surface, undersea, and air operations.²⁰⁷ In addition to Malabar, the U.S. and Indian militaries conduct five major exercises annually, as well as dozens of defense exchanges.²⁰⁸
- *Defense Cooperation Agreements:* In August 2016, the United States and India signed a long-awaited Logistics Exchange Memorandum of Agreement, which will enable (but not obligate) the two countries’ militaries to use each other’s facilities for military logistics support. According to U.S. Secretary of Defense Ashton Carter, the agreement will “make the logistics of joint operations so much easier and so much more efficient.”²⁰⁹ Pending agreements include the Communication and Information Security Memorandum of Agreement, which would enable India to use the United States’ proprietary encrypted communications system, allowing commanders from both militaries to communicate securely;²¹⁰ and a Basic Exchange and Cooperation Agreement for Geospatial Cooperation, which would enhance bilateral geospatial intelligence sharing.[‡]²¹¹
- *Defense Technology Trade:* U.S.-India defense technology trade has grown significantly in recent years, although Russia remains India’s primary arms supplier.²¹² In 2012, the two countries established the Defense Technology and Trade Initiative, which seeks to strengthen India’s indigenous defense industry, expand coproduction and codevelopment of

*Among other things, the 2005 agreement sought to enhance cooperation in the following areas: military exercises and exchanges, counterterrorism, counterproliferation, defense trade, defense science and technology exchanges, missile defense, disaster relief, and intelligence exchanges. It also created several mechanisms to coordinate efforts in these new areas of cooperation. U.S. Department of Defense, *Framework for the U.S.-India Defense Relationship*, June 28, 2005.

†In 2007, Malabar was expanded to include other militaries for the first time, with Australia, Japan, and Singapore participating in addition to the United States and India. China lodged a formal protest in response to the exercise, and India has since been careful to avoid multilateral exercises with several East Asian countries that exclude China. S. Amer Latif and Karl F. Inderfurth, “U.S.-India Military Engagement: Steady as They Go,” *Center for Strategic and International Studies*, December 2012, 24.

‡The United States and India also share a General Security of Military Information Agreement, which provides security measures for the protection of classified military information; it was signed in 2002. U.S. Department of State, *2002 Treaty Actions (July 2003 Update)*. <http://www.state.gov/s/ll/treaty/13897.htm#1>.

Facets of U.S.-India Defense Relations—Continued

defense technologies, and overcome bureaucratic obstacles to defense transfers between the United States and India.²¹³ Since 2010, the United States has also sold or licensed (or plans to sell) several military systems and components to India, including P-8I Poseidon antisubmarine aircraft, C-130 Hercules and C-17 Globemaster transport aircraft, Apache combat helicopters, CH-47F Chinook transport helicopters, aircraft engines, and munitions.²¹⁴

Although the bilateral defense relationship has achieved notable accomplishments recently, U.S. defense planners often find cooperation materializes slowly, with the United States warming to defense cooperation much more quickly than India. India's reluctance is due to several factors, including its lethargic defense bureaucracy, its nonalignment legacy and the principle of "strategic autonomy,"* and its distrust over the United States' continued military cooperation with Pakistan.²¹⁵

China is highly sensitive to U.S.-India defense cooperation, perceiving it as an effort to counter China's rise. As U.S.-India security cooperation advances, China almost certainly will view it with suspicion. As a result of this and other factors (such as India's instinctive aversion to alliance-like arrangements due to its history of nonalignment), Delhi likely will go to some lengths to avoid unnecessarily stoking tensions with Beijing. To this end, pursuing region-centric, rather than U.S.-centric, security cooperation is likely to be India's primary line of effort. India, in particular under Prime Minister Modi, has expanded high-level engagement with many countries in China's periphery with whom the United States has alliances (such as Australia, Japan, and South Korea) or growing partnerships (such as Vietnam).²¹⁶

Indian Ocean Security

China's unorthodox and destabilizing approach to advancing its maritime interests in its near seas—which has been criticized by the United States and others—raise questions about how China will pursue its objectives in the Indian Ocean, where the United States and others have an interest in upholding freedom of navigation.

Aside from the now-marginal threat of piracy and the potential for natural disasters and accidents, the Indian Ocean currently is a zone of relative peace and stability. This is due in large part to the fact that India and the United States have been the primary and uncontested maritime security providers in the region.

The Future of Tibet

On the question of Tibet, the United States has taken a nuanced approach. The U.S. government officially recognizes Tibet as part

*According to Dr. Brewster, "One of the biggest challenges in developing a [U.S.-India] security relationship is India's attachment to 'strategic autonomy'—the idea that India should never need to rely upon other countries." David Brewster, "PacNet #70: The Challenges of Building an Australia-India-US Partnership in the Indo-Pacific," *Center for Strategic and International Studies*, September 13, 2016.

of China, but has advocated for the protection of human rights, religious freedom, and the cultural and linguistic identity of the Tibetan people.²¹⁷ U.S. policy toward Tibet is guided primarily by the Tibetan Policy Act of 2002, which established the position of Special Coordinator for Tibetan Issues within the Department of State, and lists the Coordinator's "central objective" as promoting "substantive dialogue between the Government of the People's Republic of China and the Dalai Lama or his representatives."²¹⁸ With the Dalai Lama advancing in years, observers are increasingly speculating about the fate of Tibet after his death. As discussed earlier, the Chinese government has made it known that the authority of managing the Dalai Lama's succession lies with the central government—not with the current Dalai Lama, Tibetan people, or the Tibetan Buddhist religious establishment. The U.S. government has been critical of the Chinese government's position. In a June 2015 speech, Sarah Sewall, the United States Special Coordinator for Tibetan Issues, noted that "the basic and universally recognized right of religious freedom demands that any decision on the next Dalai Lama must be reserved to the current Dalai Lama, Tibetan Buddhist leaders, and the Tibetan people."²¹⁹ As a practical matter, however, the U.S. government has not made it known how it would respond if, following the death of the current Dalai Lama, the Chinese government chose to interfere in the process.

The U.S.-China-Pakistan Nexus

Pakistan holds the unique position of being a "major non-NATO ally" of the United States while also being China's closest partner. This presents both opportunities and challenges for the United States. Regarding the former, Pakistan presents opportunities for U.S.-China and U.S.-China-Pakistan cooperation on counterterrorism, both in Pakistan and in Afghanistan. The ongoing Quadrilateral Cooperation Group talks on Afghanistan's future are a potentially promising example of this kind of cooperation. However, Pakistan has also shared sophisticated U.S. defense technology with China, as in the cases of the downed U.S. stealth helicopter in Abbottabad and the transfer of an unexploded Tomahawk missile from the battlefield in Afghanistan to China via Pakistan. Pakistan also has a history of exploiting U.S.-China tensions or competition to its advantage, a situation that could intensify as the region becomes more strategically important and U.S.-China competition for influence increases. Moreover, India is deeply skeptical about U.S.-Pakistan cooperation, and views U.S. military support for Pakistan as strengthening Pakistan's capability to harm India's security.²²⁰

Conclusions

- China's key interests, concerns, and objectives in South Asia fall into four broad categories: (1) checking India's rise by exploiting the India-Pakistan rivalry, (2) expanding economic activity and influence in the region, (3) enhancing access to the Indian Ocean, and (4) countering terrorism and religious extremism. China's engagement in South Asia serves to expand its influence in the region and on the global stage.

- By virtue of its size, location, and historical and cultural influence, India has been the traditional regional power in South Asia. China, on the other hand, has forged a strong relationship with Pakistan since the 1960s, but otherwise has been a minor player in the region. Over the past decade, however, China's economic engagement (including trade, loans, and investment) with South Asia has expanded dramatically, challenging India's position. China has also been investing in infrastructure in the region, particularly ports in the Indian Ocean littoral states. South Asian countries take advantage of the Sino-Indian competition for influence in the region by playing the two countries against one another.
- Although China and India have begun to cooperate on issues of mutual interest, including Afghanistan and global economic integration, mutual suspicions undermine deeper engagement. Tensions in the relationship are driven by China's close relations with Pakistan, China's growing regional presence, the border dispute, and Tibet. To a lesser extent, tensions are aggravated by competition in the Indian Ocean and economic imbalances. Many of these trends have led Indians to perceive China is pursuing a strategy to encircle or contain India.
- In response to China's expanding activities in South Asia, India appears to have moved away from its traditional strategy of nonalignment toward more proactive engagement with its neighbors and countries in broader Asia, as well as the United States. Indian Prime Minister Narendra Modi's "Act East" and "Neighborhood First" policy initiatives, which include diplomatic, security, and economic components, are part of this effort.
- China's security concerns in South Asia historically have centered on its desire to enable Pakistan to thwart India's rise as a challenger to China's dominance in broader Asia. While this remains the most important determinant of Chinese security support to Pakistan, the rise of terrorism as a major perceived threat to China's security may be prompting a shift in this calculus as Beijing grows more concerned about Pakistan's complicated relationship with terrorist groups.
- Although China's relationship with Pakistan continues to be primarily based on shared security concerns, it has recently expanded to encompass economic and diplomatic components. China's economic commitment to Pakistan got a boost with the launch of the China-Pakistan Economic Corridor (CPEC), a \$46 billion infrastructure investment plan under the One Belt, One Road umbrella. For China, the goals of CPEC are threefold: (1) to create an alternative trade route through Pakistan and gain access to ports on the Arabian Sea; (2) to contain Islamic terrorism and insurgency in Xinjiang, and in Pakistan and Afghanistan through economic development; and (3) to stabilize Pakistan's economic and security environment. For Pakistan, CPEC presents an opportunity to address major infrastructure shortfalls, particularly energy shortages.

- Recent U.S.-China tensions in the Asia Pacific and Sino-Indian rivalry in South Asia have nurtured a much closer relationship between the United States and India. In 2015, the United States and India issued a “Joint Strategic Vision for the Asia-Pacific and Indian Ocean Region,” emphasizing cooperation in economics and security. The relationship was further enhanced during Prime Minister Modi’s visit to Washington, DC, in 2016, which culminated in extensive agreements to enhance defense technology sharing, begin a Maritime Security Dialogue, deepen cooperation on cybersecurity and outer space, and strengthen economic and trade ties. This, in turn, has led China to perceive that the United States and India are seeking to counter China’s influence in the region.
- Despite these agreements, U.S.-India cooperation in the economic, diplomatic and security realms is expected to develop slowly due to India’s adherence to the principle of “strategic autonomy,” or the idea that India should not rely on other countries.

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SECTION 2: CHINA AND TAIWAN

Introduction

On May 20, 2016, Taiwan's President Ma Ying-jeou, whose policies led to an eight-year period of improved relations between Taiwan and China, left office and Tsai Ing-wen of the Democratic Progressive Party (DPP) became president of Taiwan. President Tsai has pursued a pragmatic cross-Strait policy of "maintaining the status quo" of neither formal independence for Taiwan nor unification of Taiwan and China. However, she has not acquiesced to Beijing's demand that she endorse the "one China" framework for cross-Strait relations that Taipei and Beijing both endorsed during the Ma Administration. Although Beijing's approach to the Tsai Administration is still developing, cross-Strait relations have entered a new period, and Beijing is using various levers to pressure President Tsai, including the suspension of official communication with Taipei.

President Tsai faces tremendous challenges in formulating a cross-Strait policy, boosting Taiwan's economic growth, and addressing the threat from China's military modernization. She is pursuing the objectives of diversifying Taiwan's export markets and enhancing Taiwan's deterrent capability, efforts in which Taiwan's relationship with the United States plays a key role. U.S.-Taiwan economic and security ties are robust, but they also have areas in need of strengthening.

The United States continues to support Taiwan's efforts to participate in the international community. Taiwan's international engagement expanded during the Ma Administration, but it remains limited in many ways due to Beijing. Since President Tsai's election, Beijing has increased its pressure on Taiwan in the international arena, a problem that could grow more severe in the coming years if cross-Strait relations sour significantly.

This section explores cross-Strait relations since President Tsai's election, cross-Strait trade and investment, Taiwan's international engagement, Taiwan's military and security situation, and U.S.-Taiwan relations. It is based on consultations with experts on Taiwan and cross-Strait relations, the Commission's fact-finding trip to Taiwan and China in 2016, and open source research and analysis.

Cross-Strait Relations

Cross-Strait Political Relations after President Tsai's Election

Despite President Tsai's efforts to reassure Beijing of her policy direction, the Chinese government has suspended official communication with Taipei. Also, during the Commission's June 2016 trip to Taiwan, a Taiwan official told the Commission that China had

reduced visits to Taiwan by Chinese tourists.¹ So far, however, Beijing has refrained from taking some of the more drastic costs-imposing measures it could direct against Taipei, such as enticing countries with diplomatic relations with Taipei to cut ties and establish relations with Beijing instead, or stopping the implementation of cross-Strait agreements that were signed under the Ma Administration.²

Taiwan's 2016 Elections

Taiwan's electorate achieved several milestones in 2016: the election of Taiwan's first female president, the third peaceful transition of presidential power between political parties, and the DPP's first absolute majority in Taiwan's legislature—the Legislative Yuan. Tsai Ing-wen won the election with 56.1 percent of the vote, while Eric Chu, the presidential candidate of the Chinese Nationalist Party (Kuomintang or KMT), finished with just 31.1 percent.³ DPP candidates also won 68 seats in the Legislative Yuan compared to 35 seats for the KMT and 10 for other parties.⁴

The election outcomes were the result of voter dissatisfaction with the outgoing Ma Administration and the KMT as well as with Taiwan's struggling economy, President Tsai's focus on domestic economic issues (rather than cross-Strait relations) during the campaign, and the rising concern among Taiwan citizens about the potential negative impact of growing ties with China on Taiwan's economy and political autonomy.⁵ According to Lin Chien-fu, a professor in the department of economics at National Taiwan University, who met with the Commission in Taiwan, the problem of unaffordable housing in Taiwan also was an important issue for voters.⁶ The housing price to income ratio increased by almost one-half.⁷ Real wages fell following the 2008–2009 global financial crisis and failed to recover to pre-crisis levels in subsequent years.⁸

During President Ma's tenure, which was characterized by a thaw in some aspects of cross-Strait relations and a reduction in overall tensions, Taiwan and China signed 23 cooperation agreements and expanded economic, educational, travel, and government-to-government contacts and communication. These initiatives culminated in a meeting between President Ma and Chinese President and General Secretary of the Chinese Communist Party Xi Jinping in Singapore in November 2015, the first meeting between the leaders of Taiwan and China since 1949. During President Ma's two terms in office, however, Taiwan's economic growth slowed significantly amid stagnant wages, unemployment in Taiwan's largely high-skilled workforce, weak entrepreneurial innovation, low inbound investment, and an electorate increasingly worried about China's ability to influence Taiwan and the impact of agreements with China on Taiwan's economy.⁹

Taiwan's Economic Challenges

Taiwan faces many economic challenges. First among them is the Taiwan economy's dependence on exports, particularly to China. (See section on "Cross-Strait Trade and Investment" for more information.) The Tsai Administration seeks to shift Taiwan's "efficiency-driven model" to an "innovation-driven model."¹⁰ The efficiency-driven model refers to Taiwan's economic strategy of linking itself to regional supply chains, primarily through China, and expanding exports to increase growth. A Taiwan official told the Commission that the Taiwan government wants to collaborate with the United States, Japan, Europe, and Israel to develop a model for innovation in Taiwan and collaborate in the areas of research and development (R&D), human resources, and financial capital. Taipei is also interested in expanding economic exchanges with India by, for example, encouraging Indian engineers to move to Taiwan and by encouraging collaboration among Indian and Taiwan technology industries.¹¹ Furthermore, the Tsai Administration is promoting the development of five "strategic industries": green energy, defense, the Internet of Things, biotechnology, and smart precision machinery.¹²

Access to energy is a looming concern: observers in Taiwan told the Commission that Taiwan may face electricity brownouts by 2017 due to low energy reserves.¹³ Taiwan is highly dependent on imported energy sources to fuel its export-oriented industries. Currently, about 98 percent of the energy that Taiwan consumes is imported. Of that amount, the vast majority comprises fossil fuels from the Middle East.¹⁴ Taiwan has three active nuclear power stations, all of which are scheduled to be decommissioned between 2018 and 2025.¹⁵ The state-owned electricity provider, Taipower, financed the construction of a fourth nuclear power station, which was set to become operational by 2015. In 2014, however, Taiwan's government voted to halt construction of the plant amid protests and safety concerns following the 2011 Fukushima nuclear disaster in Japan.¹⁶

Observers in Taiwan also told the Commission that Taiwan is experiencing a "brain drain."¹⁷ A scholar explained that this problem is the result of low wages, income disparity, and high housing prices.¹⁸

Although there is no indication that developments in Hong Kong played a role in the election outcomes in Taiwan, activists in Taiwan are concerned about the fate of freedom and democracy in Hong Kong and have demonstrated support for activists there.¹⁹ More broadly, the idea of adopting Hong Kong's "one country, two systems"* framework—Beijing's stated framework for cross-Strait unification—as a model for Taiwan has long been unpopular among the Taiwan public. However, J. Michael Cole, senior non-resident

*The "one country, two systems" framework is a policy measure adopted by the People's Republic of China following the establishment of Hong Kong and Macau as Special Administrative Regions. The system grants Hong Kong and Macau the right to self-govern their economy and political system to a certain extent, excluding foreign affairs and defense.

fellow at the University of Nottingham's China Policy Institute, told the Commission that developments in Hong Kong have intensified the Taiwan public's opposition to Chinese rule and the one country, two systems framework.²⁰ (See Chapter 3, Section 3, "China and Hong Kong," for more information on developments in Hong Kong.)

President Tsai's Cross-Strait Policy

President Tsai campaigned on solving domestic economic and social problems and a pragmatic cross-Strait policy of "maintaining the status quo" in Taiwan's relations with China. She expressed her commitment to peace in the Taiwan Strait and a "consistent, predictable, and sustainable" cross-Strait relationship.²¹ During a speech in Washington, DC, in June 2015, she explained that "the conduct of cross-Strait policy must transcend the position of a political party and incorporate different views."²² She went on to say, "If elected President, I will push for the peaceful and stable development of cross-Strait relations in accordance with the will of the Taiwanese people and the existing [Taiwan] constitutional order. [The accumulated outcomes of more than 20 years of negotiations and exchanges] will serve as the firm basis of my efforts."²³ These statements appeared intended to reassure the Chinese government that she would not pursue formal independence for Taiwan.

Since her election, President Tsai has built on this policy platform and taken several additional steps to signal goodwill and flexibility and reassure Beijing about her intentions. During the campaign and in the months after the Taiwan elections, Beijing consistently and repeatedly insisted cross-Strait relations must be conducted through the framework of the "1992 Consensus"—a tacit understanding reached at a meeting between representatives of Taiwan and China in 1992 that there is only "one China" but that each side may maintain its own interpretation of the meaning of "one China."²⁴ Unlike President Ma, President Tsai has not explicitly endorsed the 1992 Consensus, but she has moved closer to China's framework in her articulation of her cross-Strait policy. Explaining the policy in an interview with Taiwan's *Liberty Times* several days after the election, President Tsai reiterated that representatives of Taiwan and China had in fact met in 1992 and that they sought to "find common ground and put aside differences."²⁵ She also said that during the meeting, the two sides "achieved several common understandings and acknowledgments" and that she "understands and respects that historical fact."²⁶ Then, during her inauguration address in May 2016, she stated that her administration would conduct cross-Strait relations in accordance with Taiwan's Act Governing Relations between the People of the Taiwan Area and the Mainland Area.²⁷ Richard C. Bush, director of the Brookings Institution's Center for East Asia Policy Studies, wrote that "the references to the two 'areas' could be taken to imply that

*The KMT and the Chinese government assert that this consensus was reached, but the DPP rejects the existence of this consensus.

†This law, which was passed in 1982 and has been amended many times, pertains to travel, employment, marriage, and other legal matters. It refers to Taiwan and mainland China as areas and thus implies they are part of the same country. Taiwan's Mainland Affairs Council, *Act Governing Relations between the People of the Taiwan Area and the Mainland Area*.

they are part of the same country and so satisfy Beijing.”²⁸ These statements do not seem to have satisfied Beijing, however.

Beijing’s Approach to President Tsai

Beijing’s approach to President Tsai has been a combination of statements of insistence on the 1992 Consensus and opposition to independence for Taiwan, warnings and other measures meant to put pressure on her administration, and some demonstrations of nuance and potential flexibility. During a press conference at the end of January 2016, in response to a question about cross-Strait relations, a spokesperson for China’s Taiwan Affairs Office (TAO)* said, “For over 20 years, the history of the development of cross-Strait relations has already thoroughly proven that by insisting on the common political framework of the ‘1992 Consensus’ and opposition to ‘Taiwan independence,’ the prospects for cross-Strait relations are bright. If this does not happen, the boat of peaceful development of cross-Strait relations will encounter terrifying waves and could even capsize completely.”²⁹ The spokesperson made a similar statement in his response to another question later in the press conference, and in several other responses to questions he gave implicit warnings about what might happen if the Tsai Administration did not accept Beijing’s cross-Strait framework.³⁰

Despite these hardline statements, Beijing later demonstrated some nuance and potential flexibility in the remarks of Minister of Foreign Affairs Wang Yi. In February, after delivering a speech in Washington, DC, Minister Wang responded to a question about the impact of the election on ties between China and Taiwan first by striking a calm tone about President Tsai’s election, saying it was “just a change of government in Taiwan. . . . It’s something natural. It should not come as too big a surprise.”³¹ Then, in the most noteworthy part of his response, he said that he hopes and expects President Tsai would “indicate that she wants to pursue the peaceful development of cross-straits relations, and that she will accept the provision in Taiwan’s own constitution that the mainland and Taiwan belong to one, the same China.”³² Minister Wang then added a veiled warning,[†] but his statement about Taiwan’s constitution—although not identical to President Tsai’s statement—echoed her pledge to conduct cross-Strait relations according to the “existing [Taiwan] constitutional order.” Mr. Cole wrote, “Although we should not read too much into the foreign minister’s comments . . . it nevertheless hints at the possibility of a more flexible, and perhaps more pragmatic, approach to Taiwan.”³³

During March meetings in China with a delegation of U.S. analysts organized by the Center for Strategic and International Studies, Chinese interlocutors articulated several areas where Beijing claimed to demonstrate goodwill and flexibility. Bonnie S. Glaser, senior advisor for Asia and director of the China Power Project at

*The Taiwan Affairs Office is an agency within China’s State Council that is responsible for overseeing China’s cross-Strait policies.

†Minister Wang said that people in Taiwan will not accept a violation of Taiwan’s constitution, because “they want to see the continued peaceful development of cross-straits relations. They want to see more mainland visitors. They want to pursue more business ties with the mainland. And they want to live in a climate of peace and tranquility. The next government in Taiwan must think about these issues in a serious way.” Wang Yi, “Statesman’s Forum: Wang Yi, Minister of Foreign Affairs, PRC” (Washington, DC, February 25, 2016).

the Center for Strategic and International Studies, writes that the interlocutors made the following points:

The Chinese believe that they have shown some flexibility and goodwill to Tsai Ing-wen and the DPP. For example, Beijing has indicated that if the DPP cannot embrace the 1992 Consensus, it “can come up with a new version” using alternative wording to express its core meaning. Another example of the Mainland’s goodwill cited by the Chinese side is the policy of not demanding more from the DPP than it has asked of the KMT. From Beijing’s perspective, it is not raising the bar and is not unilaterally changing the cross-Strait status quo. Rather, it is Tsai and the DPP that is changing the status quo. A third example that the Mainland says is a sign of its goodwill toward the DPP is Xi Jinping’s statement at the [National People’s Congress] that Beijing’s policies and principles toward Taiwan will not change because of changes in Taiwan’s political situation, including willingness to pursue peaceful development of cross-Strait relations.³⁴

In March, China re-established diplomatic relations with The Gambia, which Beijing had theretofore opted against following The Gambia’s severing of its diplomatic ties with Taiwan in 2013.³⁵ In 2008, at the beginning of the Ma Administration, Taiwan and China reached a tacit understanding—what President Ma unilaterally declared to be a “diplomatic truce”—to stop poaching each other’s diplomatic partners in order to maintain positive momentum in the cross-Strait relationship.³⁶ Although Beijing’s move to establish relations with The Gambia technically did not break the diplomatic truce—because The Gambia had already cut ties with Taiwan in what appears to have been a decision that was not influenced by Beijing*—it was almost certainly intended to convey to the Tsai Administration that Beijing is willing to draw away countries with which Taiwan has diplomatic relations.³⁷

In the context of a discussion of the Chinese government’s response to the Tsai Administration, one Taiwan official told the Commission that China had significantly reduced Chinese tourism to Taiwan.³⁸ According to Taiwan’s Mainland Affairs Council (MAC),† between May 20 and August 16, Chinese tourists traveling to Taiwan with tour groups fell by 37 percent.³⁹ In September, an estimated 10,000 Taiwan tourism industry workers and representatives marched in Taipei to call for assistance from the government in response to the drop in Chinese tour groups.⁴⁰ During the Ma Administration, Taiwan reduced barriers to Chinese tourists visiting Taiwan and the number of Chinese tourists increased from around 330,000 in 2008 to about 4.2 million in 2015.⁴¹ According to one calculation based on data from Taiwan’s Bureau of Tour-

*There is no public evidence that suggests Beijing enticed or pressured The Gambia to cut diplomatic relations with Taiwan. According to Taiwan’s Minister of Foreign Affairs, The Gambia’s decision was the result of Taiwan’s rejection of a request by The Gambia’s president for more aid. Angela Tsai and Scully Hsiao, “Gambian Aid Request Linked to Broken Ties with Taiwan: Minister,” Central News Agency (Taiwan), November 25, 2013.

†The Mainland Affairs Council is a cabinet-level agency in Taiwan’s executive branch that is responsible for overseeing Taiwan’s cross-Strait policies.

ism, the revenue from Chinese tourists in Taiwan reached \$6.8 billion in 2015.⁴²

Beijing's insistence on the "one China" principle precludes any country or international organization from simultaneously diplomatically recognizing China and Taiwan, thereby restricting Taiwan's full participation in the international community. Due to Beijing's insistence on this principle, Taiwan generally can only participate in international fora using other names, such as "Chinese Taipei." In May, Beijing apparently agreed to Taiwan's continued participation as an observer in the annual conference of the UN World Health Organization's World Health Assembly. The World Health Organization has extended an invitation to Taiwan to participate as an observer every year since 2009. This year's conference was held several days after President Tsai's inauguration, and a Taiwan official announced that Taiwan had received the invitation on May 6.⁴³

Beijing has tried to put the onus on the Tsai Administration to maintain positive cross-Strait relations and positioned itself to deflect all responsibility should relations sour. During a press conference on May 11, a TAO spokesperson said:

*Who is working hard to protect the common political foundation and protect the peaceful development of cross-Strait relations and who is destroying the common political foundation of cross-Strait relations and changing the status quo of cross-Strait relations, who is protecting roads and who is tearing down bridges, I believe everyone can see very clearly. . . . If there is gridlock in cross-Strait relations or a crisis occurs, the responsibility is on those who change the status quo.*⁴⁴

Beijing continued to pressure the Tsai Administration in its response to President Tsai's inauguration speech on May 20. TAO director Zhang Zhijun delivered a statement in which he said, "The contact and communication mechanism between the Mainland's Taiwan Affairs Office and Taiwan's Mainland Affairs Council and the consultation and negotiation mechanism between the Association for Relations Across the Taiwan Straits and Taiwan's Straits Exchange Foundation* are built on the political foundation of the 1992 Consensus. Only by affirming the political foundation that embodies the One China principle can the institutionalized cross-Strait exchanges continue."⁴⁵

Since President Tsai's inauguration, Beijing has followed through on its warning, at least in part, and suspended "the cross-Strait contact and communication mechanisms."⁴⁶ In June 2016, a TAO spokesperson announced that "the cross-Strait contact and communication mechanisms have been suspended because Taiwan did not recognize the 1992 Consensus, the political basis for the One China principle."⁴⁷ The spokesperson noted the mechanism had been suspended since President Tsai's inauguration.⁴⁸ Earlier that month, the deputy minister of MAC said that communication between the

*The Straits Exchange Foundation and the Association for Relations Across the Taiwan Strait facilitate cross-Strait negotiations in the absence of formal ties between the governments of Taiwan and China. Although the two bodies are semiofficial organizations, they receive direction from their respective governments.

two governments was ongoing at the division director level.⁴⁹ Also in June, a Taiwan official told the Commission that Beijing suspended formal exchanges between MAC and TAO, but informal communications through “desk phones and fax machines” still occur.⁵⁰ Beijing also has suspended communication and meetings between the Straits Exchange Foundation and the Association for Relations Across the Taiwan Straits.⁵¹ According to an article published on May 31, an anonymous individual affiliated with China’s Association for Relations Across the Taiwan Straits told Taiwan’s *United Daily News* that the association had not responded to any faxes or telephone calls from the Taiwan side since the inauguration.⁵² In July, during an interview with the *Washington Post*, President Tsai was asked, “Since your inauguration in late May, the Chinese have cut off the official channel that was used to communicate between Taiwan and the mainland. How do you plan to handle day-to-day relations with Beijing?” President Tsai responded, “We have always had diverse channels of communication across the strait. These include not just official communications but also people-to-people contacts.” Then, when asked, “Are you, the president, in touch with your counterparts in the Chinese government?” she said, “Different levels of the government have different ways of communicating with their counterparts in China. At this stage, I cannot go into too much detail.”⁵³

Cross-Strait Agreements

In August, the TAO director told Taiwan business representatives in China that Beijing would continue to honor the 23 existing cross-strait agreements signed under the Ma Administration.⁵⁴ However, since China has made official and quasi-official cross-strait exchanges contingent on Taiwan’s acknowledgement of the 1992 Consensus and thus far has expressed dissatisfaction with President Tsai’s attempts to reach a compromise on this issue, the potential for additional cross-strait agreements is uncertain. Regarding potential new agreements, the TAO director said, “It is impossible for the doors to be open without the ‘1992 consensus’ as a foundation.”⁵⁵ The Ma Administration had engaged in negotiations with Chinese counterparts on a trade in goods agreement and an agreement on reciprocal representative offices in each other’s territory, but the two sides had not yet concluded the talks on either of these potential agreements.

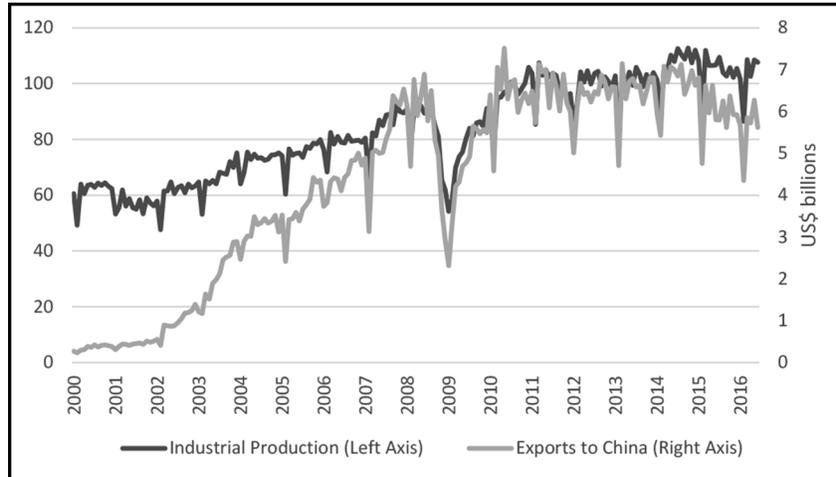
The fate of the Cross-Strait Trade in Services Agreement (CSSTA), which Taiwan and China signed in 2013 but the Taiwan legislature has not ratified, is also uncertain. The Tsai Administration plans to wait until the legislature passes a cross-strait agreements oversight bill before it addresses the future of the CSSTA and continues negotiations on the trade in goods agreement.⁵⁶ The CSSTA has been stalled in the legislature since March 2014, when protestors occupied the legislative chamber in opposition to the agreement—a protest movement that was given the name the Sunflower Movement. Protestors were concerned that the Ma Administration conducted the negotiations in a nontransparent manner and the Legislative Yuan had not reviewed the agreement. To end the occupation, one of the terms to which the then legislative speaker agreed was the creation of an oversight mechanism for cross-strait

agreements.⁵⁷ Since then, many draft bills for such a mechanism have been proposed, but they were not debated.⁵⁸ Much of the political logjam was the result of disagreement over the roles of the Legislative Yuan and the Executive Yuan (Taiwan's executive branch) in the oversight process.⁵⁹ Ker Chien-Ming, head of the Legislative Yuan's DPP caucus, said in August 2016 that the Legislative Yuan would review the bill during the fall legislative session.⁶⁰ How the bill will fare is uncertain. Although the DPP has a majority in the Legislative Yuan, the version of the bill proposed by the DPP caucus has been criticized by civil society groups.⁶¹ In addition, Mr. Ker in January 2016 said that the DPP's stance on the CSSTA was that the agreement should be renegotiated.⁶² Although it is unknown whether the Tsai Administration will call for the agreement to be renegotiated, if it chooses to do so, the question remains whether Beijing will agree.

Cross-Strait Trade and Investment

In 2015, Taiwan's economic growth slowed to less than 1 percent as exports dropped significantly amid China's economic slowdown and low global demand.⁶³ Taiwan's exports also were hurt by increased competition from Chinese high-tech suppliers, which undercut them on cost.⁶⁴ With China ranking as its largest trading partner, Taiwan's export-oriented economy is dependent on China and vulnerable to fluctuations in China's economy.⁶⁵ Taiwan's industrial production* has grown increasingly tied to its China-bound exports. In the years after Taiwan joined the World Trade Organization, Taiwan's exports to China grew rapidly as Taiwan-based firms expanded manufacturing operations in China and established regional supply chains, especially in information technology products. By the time the Ma Administration took office in 2008, fluctuations in Taiwan's industrial production closely tracked exports to China (see Figure 1).⁶⁶

*Industrial production is quantified using the industrial production index, which measures outputs of the industrial sector of the economy, including manufacturing, mining, and utilities.

Figure 1: Taiwan's Industrial Production, 2000–2016

Note: 2016 data are through June. The export data in this figure include re-exports.

Source: Taiwan Ministry of Economic Affairs and Ministry of Finance via CEIC database.

Scholars at the Chung-Hua Institute for Economic Research told the Commission that although Taiwan's economy showed negative gross domestic product (GDP) growth in the first two quarters of 2016, Taiwan's manufacturing will pick up in the final two quarters to make up for these losses. Taiwan's GDP growth tends to fluctuate based on the release schedules of certain products that Taiwan companies help to produce. For example, Taiwan had exceptionally good GDP growth in 2014, mainly attributable to high sales of the iPhone 6 rather than any sustained improvement in Taiwan's economic situation.⁶⁷

To address Taiwan's economic dependence on China, the Ma Administration strived to diversify Taiwan's export markets, efforts that President Tsai has continued. President Tsai and the DPP have emphasized their objective of moving Taiwan toward participation in the U.S.-led Trans-Pacific Partnership (TPP) trade agreement, and President Tsai is moving forward with plans to enhance Taiwan's trade and investment with the countries of Southeast Asia, South Asia, and Oceania, part of her "New Southbound Policy," which is discussed later in this section.⁶⁸

Goods Trade

As of August 2016, China remains Taiwan's largest trading partner, biggest export market, and top source of imports.*⁶⁹ In 2015, annual cross-Strait trade totaled \$111.4 billion,† comprising 22.6 percent of Taiwan's total trade.⁷⁰ However, total cross-Strait trade also decreased by about 11 percent in 2015 compared to 2014.⁷¹

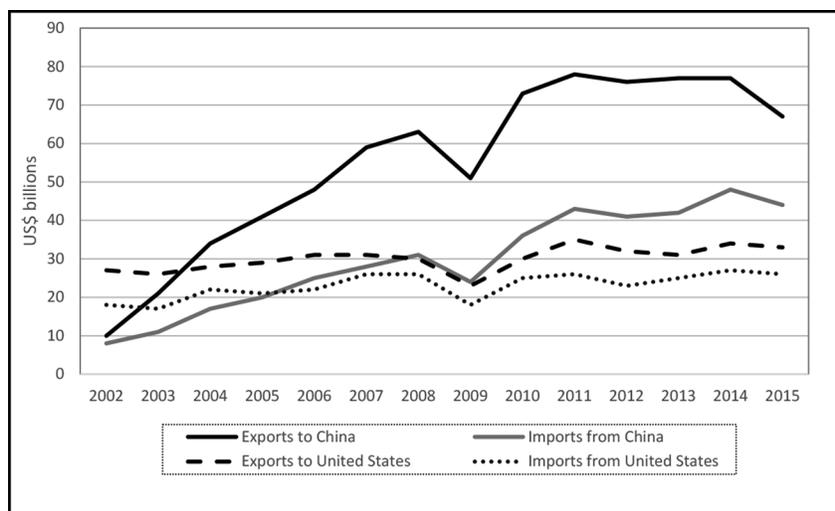
Taiwan's exports to China have been hit hard by the slowdown of China's economy.⁷² Taiwan's exports to China in 2015 were

*Trade statistics in this section do not include Taiwan's trade with Hong Kong.

†All trade statistics from Taiwan's Bureau of Foreign Trade in this section exclude re-exports and re-imports.

\$67.2 billion, comprising 25.4 percent of Taiwan's exports to the world.⁷³ Year-on-year, Taiwan's exports to China shrank by 13.2 percent and its trade surplus with China decreased by 21.5 percent in 2015 (see Figure 2).⁷⁴ Taiwan's exports to China were dominated by semiconductor-related and liquid crystal display-related products in 2015.⁷⁵ These products composed all of Taiwan's top five exports to China and more than a quarter of the value of Taiwan's total exports to China (see Figure 3).⁷⁶ Taiwan's exports of these top five products to China decreased by 17.8 percent in 2015.⁷⁷

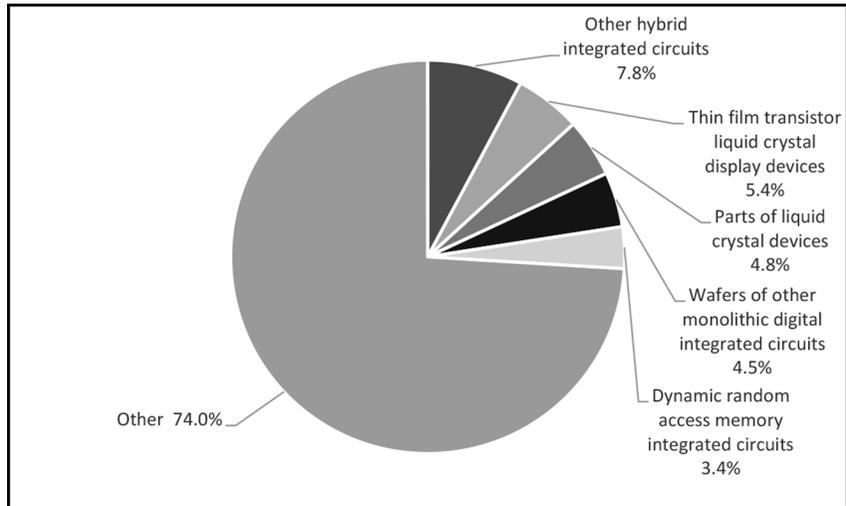
Figure 2: Taiwan's Trade with China and the United States, 2002–2015



Source: Taiwan's Bureau of Foreign Trade, "Trade Statistics." <http://cus93.trade.gov.tw/ENGLISH/FSCE/>.

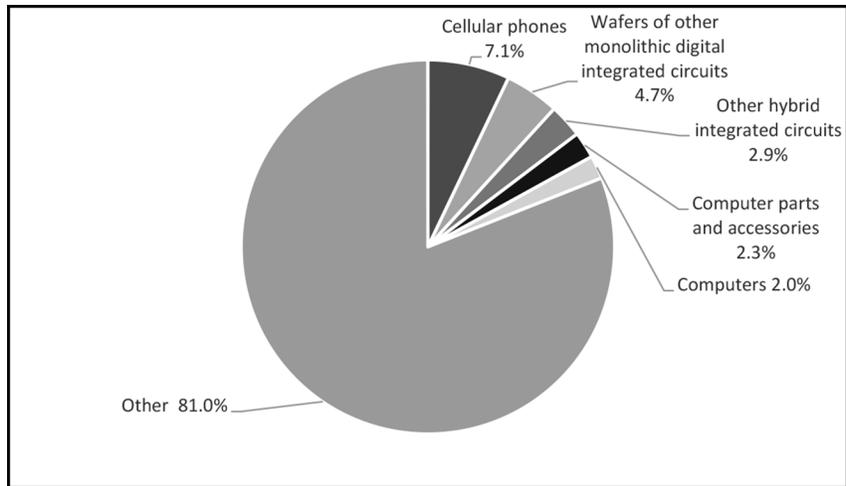
Taiwan's imports from China in 2015 were \$44.2 billion, comprising 19.4 percent of its total imports.⁷⁸ Despite imports from China decreasing by 8 percent, China remained Taiwan's largest source of imports.⁷⁹ Just as semiconductor-related products were among Taiwan's top exports to China, they also were among Taiwan's main imports from China.⁸⁰ (Taiwan firms generally design and manufacture unfinished microchips and other semiconductor-related products in Taiwan for assembly and testing in China; China then typically exports the finished products back to Taiwan.)⁸¹ Taiwan's other major imports from China included cellular phones and computers and computer parts and accessories.⁸² Despite the overall decrease in imports, imports of cellular phones increased by 37.6 percent and imports of wafers for microchips increased by 10.2 percent.⁸³ Both cellular phones and wafers for microchips were among Taiwan's top five imports from China (see Figure 4).⁸⁴ Imports of the other top five products all decreased, with microchips decreasing by 14.3 percent, computer parts and accessories decreasing by 7.1 percent, and computers decreasing by 15.8 percent.⁸⁵

Figure 3: Taiwan's Top Five Exports to China, 2015



Source: Taiwan's Bureau of Foreign Trade, "Trade Statistics." <http://cus93.trade.gov.tw/ENGLISH/FSCE/>.

Figure 4: Taiwan's Top Five Imports from China, 2015



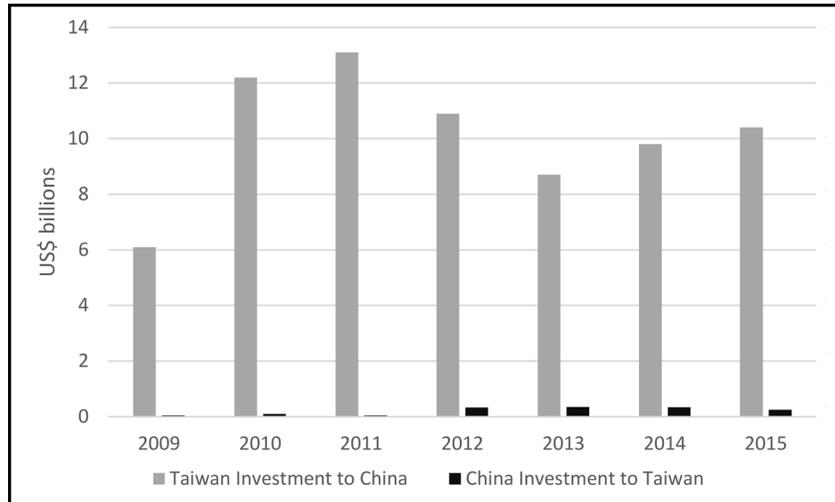
Source: Taiwan's Bureau of Foreign Trade, "Trade Statistics." <http://cus93.trade.gov.tw/ENGLISH/FSCE/>.

Foreign Direct Investment

China is Taiwan's top destination for foreign direct investment (FDI).⁸⁶ According to official Taiwan data, Taiwan FDI to China in 2015 totaled \$10.4 billion.⁸⁷ Between 2014 and 2015, this number increased by 5.8 percent.⁸⁸ In 2015, for the second year in a row, Taiwan FDI to China recorded growth after decreasing in 2012 and 2013 (see Figure 5).⁸⁹ The growth in FDI over the past two years was primarily the result of new Taiwan FDI in the electronic parts manufacturing and computer manufacturing sectors in 2014, followed by an increase in Taiwan FDI in the financial and insurance sectors and the non-metal mineral products manufacturing industry in 2015.⁹⁰ In 2015, investment in the financial and insurance sectors comprised the largest percentage of Taiwan's total FDI in China, with 25.4 percent.⁹¹ The next largest recipients of Taiwan FDI in China in 2015 were electronic parts and components manufacturing (11.2 percent) and computers, electronic, and optical products manufacturing (10.1 percent).⁹²

Year-on-year, the value of Chinese investment in Taiwan dropped by about 27 percent to approximately \$244 million in 2015, but the number of Chinese investment cases approved by the Taiwan government increased by 25 percent to 170.⁹³ According to Taiwan's National Development Council, a policy planning organization under the Executive Yuan, the number of cases increased while the value decreased, primarily because the majority of Chinese investment in Taiwan is in services, and investments in services are generally smaller than those in manufacturing. The council reported that the percentage of Chinese investments in services increased by 9.7 percent to a total of 79.4 percent of all Chinese investment in Taiwan in 2015.⁹⁴ FDI from China had been steady between 2012 and 2014 after it more than tripled between 2010 and 2012,⁹⁵ a spike largely due to the Ma Administration's loosening of investment caps and regulations on Chinese investment into Taiwan.* Chinese investments are still limited. All investments require Taiwan government approval, and the Taiwan government prohibits Chinese investors from appointing managers or having controlling stakes.⁹⁶ In 2015, 62.4 percent of the value of Chinese FDI to Taiwan was in wholesale and retail, 10.4 percent was in electronic parts and electronic components manufacturing, and 7.3 percent was in information and software services.⁹⁷

* For example, in March 2012, Taiwan loosened Chinese investment caps of 10 percent stakes in local firms and 50 percent in joint ventures in Taiwan's semiconductor and metal tool manufacturing sectors, among others. PricewaterhouseCoopers, "Chapter 4: The Bigger Picture—China's Impact on the Semiconductor Industry 2012 Update," September 2012.

Figure 5: Cross-Strait Investment, 2009–2015

Source: Taiwan's Ministry of Economic Affairs, Investment Commission, *Monthly Report*, December 2015.

Taiwan's International Engagement

Taiwan continues to pursue greater participation in the international community through its official diplomatic relations with 22 countries,* efforts to expand its participation in international organizations, and initiatives to strengthen economic and unofficial diplomatic partnerships with countries other than China. As discussed previously, one of Taiwan's successes in 2016 was its continued participation in the World Health Assembly as an observer. This year also saw new and ongoing challenges to Taiwan's ability to participate in the international community, however. It is unclear whether all of these developments were part of a concerted effort by Beijing to pressure the Tsai Administration, but should Beijing seek to increase pressure on Taipei, it may move to further limit Taiwan's participation in international organizations and invite some countries with which Taiwan has diplomatic relations to cut ties and establish diplomatic relations with China.

Efforts to Expand International Participation

Taiwan's "New Southbound Policy": One of the Tsai Administration's main initiatives to expand Taiwan's international participation is its "New Southbound Policy" of enhanced engagement with the countries of Southeast Asia, South Asia, and Oceania.⁹⁸ Although a major objective of the initiative is to expand Taiwan's trade and investment with these countries in order to diversify its export markets, President Tsai and James Huang, the official who

* Taiwan has diplomatic relations with Belize, Burkina Faso, the Dominican Republic, El Salvador, Guatemala, Haiti, the Holy See, Honduras, Kiribati, the Marshall Islands, Nauru, Nicaragua, Palau, Panama, Paraguay, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Sao Tome and Principe, Solomon Islands, Swaziland, and Tuvalu. Taiwan's Ministry of Foreign Affairs, "Diplomatic Allies."

is leading the initiative, have said that it will be focused on much more than trade and investment.⁹⁹ According to its guidelines, the initiative will include cooperation in the areas of agriculture, education, culture, and tourism.¹⁰⁰

Seeking participation in INTERPOL: According to Taiwan's Criminal Investigation Bureau, Taiwan's exclusion from the International Criminal Police Organization (INTERPOL) means that it does not receive updates from the organization on transnational crimes, and Taiwan police cannot participate in training provided by INTERPOL.¹⁰¹ In March, U.S. President Barack Obama signed a bill (S. 2426) that mandates the secretary of State to report to Congress within 90 days on the U.S. government's strategy for supporting Taiwan's participation in INTERPOL as an observer. This bill is another step in the U.S. government's longstanding efforts to advocate on behalf of Taiwan's participation in international organizations. President Obama signed a similar bill (H.R. 1151) in 2013 regarding a U.S. strategy to support Taiwan's participation as an observer in the UN's International Civil Aviation Organization (ICAO).*

Challenges

Not invited to participate in the 2016 ICAO Council Assembly: In September, Taiwan's Minister of Foreign Affairs confirmed that ICAO did not invite Taiwan to participate in the ICAO Council Assembly, which was held in late September and early October, in a reversal from the previous assembly. A spokesperson for China's TAO said Taiwan could not participate because the Tsai Administration had not endorsed the 1992 Consensus.¹⁰² The president of the ICAO Council invited Taiwan to participate as his guest in the 2013 ICAO Council Assembly, a forum which is held every three years. The 2013 assembly was the first official ICAO meeting to which Taiwan had been invited in 42 years.¹⁰³

Blocked from other UN meetings and OECD meeting: In April, under pressure from China, the Belgian government barred a Taiwan government delegation from attending a meeting on the steel sector organized by the Belgian government and the Organisation for Economic Co-Operation and Development (OECD) in Brussels. The delegation had already attended a meeting that was part of the same symposium earlier in the day. Although Taiwan is not a member of the OECD, it has been allowed to attend some OECD meetings since 2002.¹⁰⁴ In June, a professor of labor relations from Taiwan's Chung Cheng University and a study group she was leading were blocked twice from attending an annual conference of the UN's International Labor Organization. The professor had led study groups to attend the conference in 2014 and 2015 without a problem.¹⁰⁵ In July, Taiwan officials were not allowed to participate in a meeting of the Food and Agriculture Organization of the UN's Committee on Fisheries, an organization in which they have been permitted to participate since 2003.¹⁰⁶

*The U.S. Department of State submitted both reports to Congress. Executive Communication EC5932, 114th Cong., 2nd Sess., June 28, 2016.

Difficulty joining the Asian Infrastructure Investment Bank: In early April, the president of the Asian Infrastructure Investment Bank announced that if Taiwan wanted to join the bank China's Ministry of Finance would have to apply on its behalf. This is the same standard the bank applied to Hong Kong, thereby treating Taiwan as if it were part of China. The Taiwan government rejected this condition, stating, "It hurts our dignity."¹⁰⁷

Failed repatriation of fraud suspects: Between April and September, about 200 Taiwan citizens living in Armenia, Cambodia, Kenya, and Malaysia who were accused of committing telecommunications fraud against people in China were deported from those countries to China, rather than to Taiwan.¹⁰⁸ At the beginning of the Ma Administration, Taipei and Beijing signed the Cross-Strait Joint Crime-Fighting and Judicial Mutual Assistance Agreement, which includes the return of individuals suspected of and convicted of crimes from one side to the other.¹⁰⁹ In 2011, after the Philippines deported 14 Taiwan citizens suspected of telecommunications fraud to China, cross-Strait negotiations led Beijing to return the suspects to Taiwan.¹¹⁰ Subsequently, Taipei and Beijing developed a pattern of law enforcement cooperation in countries with which Taiwan does not have official diplomatic relations, though this cooperation was not part of the 2009 agreement.¹¹¹ This cooperation enabled Taiwan to bring many Taiwan citizens who were suspected of committing crimes in those countries back to Taiwan.¹¹² Beijing has been unwilling to continue this cooperation since President Tsai was elected. However, Beijing's initial motivation for not allowing the suspects to be sent to Taiwan may solely have been its desire to crack down on telecommunication fraud against Chinese citizens. The first group of Taiwan citizens who were deported from Kenya in April 2016 had been arrested in December 2014 and Beijing requested that they be sent to China in January 2015, one year before President Tsai was elected.¹¹³ Nonetheless, Beijing is now likely also using these cases as another means to pressure Taipei.*¹¹⁴

Threat of severed diplomatic relations: No countries have severed diplomatic ties with Taiwan since President Tsai's election, and there is no evidence to suggest China has invited them to do so. Zhang Zhixin, a research fellow at the Shanghai Institute for International Studies, estimated in 2013 that Beijing had rejected overtures from at least five countries with diplomatic relations with Taiwan since then President Ma was elected in 2008.¹¹⁵ However, Beijing could establish ties with some of these countries if cross-Strait relations significantly worsen.¹¹⁶ In 2016, Beijing and the

*During a press conference in August a reporter requested a TAO spokesperson confirm whether MAC had protested to Beijing through cross-Strait communication channels regarding Kenya's deportation of Taiwan citizens to China. In his response, the spokesperson reiterated that the mechanisms for cross-Strait communication and talks had been suspended because Taipei had not endorsed the 1992 Consensus. He added that "the Taiwan side should face up to this fact and make practical efforts to resume the working of these mechanisms." Xinhua, "Taiwan Affairs Office: The People on Both Sides of the Strait Support Cracking Down on Telecommunications Fraud According to Law. The Taiwan Side Should Make Practical Efforts to Resume the Working of the Cross-Strait Contact and Communication Mechanisms," *China's Taiwan Affairs Office*, August 8, 2016.

Vatican—which has diplomatic relations with Taiwan*—were reportedly in talks to address longstanding areas of disagreement. The two sides have disagreed about whether the Vatican should be allowed to appoint bishops in China as it does elsewhere. The Vatican also does not approve of eight bishops that were appointed by the Chinese government.¹¹⁷ A resolution of these issues and warming of relations between China and the Holy See could put Taiwan's relations with the Vatican at risk.

Difficulty signing free trade agreements: Taiwan is at a disadvantage when competing economically with other countries such as South Korea, because it is more difficult for Taiwan to sign free trade agreements¹¹⁸—in large part because Beijing pressures other countries not to sign free trade agreements with Taiwan.¹¹⁹

The Tsai Administration's Approach to the East and South China Sea Disputes

Taiwan, which is one of six claimants of land features in the South China Sea,† rejected the ruling of the arbitral tribunal at the Permanent Court of Arbitration in The Hague in the case *The Republic of Philippines v. The People's Republic of China* in July,‡ though Taipei's response has not been nearly as vociferous as Beijing's. Taiwan stated several reasons for rejecting the ruling: (1) it deemed the tribunal's designation for Taiwan ("Taiwan Authority of China") incorrect and "demeaning to the status of [Taiwan] as a sovereign state;" (2) the tribunal did not formally invite Taiwan to participate in the case or ask for Taiwan's views;¹²⁰ and (3) although Taiwan-controlled Itu Aba (a land feature in the Spratly Islands called Taiping Island by Taiwan and China) was not originally included in the Philippines' submission, the tribunal ruled that it is a rock rather than an island (see Figure 6).§ Itu Aba is the largest natural land feature in the Spratly Islands and the only one that Taiwan controls; some observers thought it had a strong chance of being designated an island, instead of a rock, by the tribunal.¹²¹ Taiwan's Ministry of Foreign Affairs also stated, "That [Taiwan] is entitled to all rights over the South China Sea Islands and their relevant waters in accordance with international law and the law of the sea is beyond dispute."¹²² The day after the tribu-

*The Vatican established ties with the Republic of China government in 1942 and maintained those ties after the government moved to Taiwan and Beijing expelled the Vatican's ambassador from China in 1951. Kevin Hsu, "China and the Vatican: Toward a New Era?" *Diplomat* (Japan), September 22, 2016.

†The other claimants are Brunei, China, Malaysia, the Philippines, and Vietnam. See Chapter 2, Section 1, "Year in Review: Security and Foreign Affairs" for more information on the East and South China seas disputes.

‡For more information on the tribunal's ruling, see Caitlin Campbell and Nargiza Salidjanova, "South China Sea Arbitration Ruling: What Happened and What's Next?" *U.S.-China Economic and Security Review Commission*, June 12, 2016.

§The distinction, as defined by the UN Convention on the Law of the Sea, between an island and a rock is important because each type of feature generates a different maritime entitlement. Islands, which must be above water at high tide and be capable of sustaining human habitation or economic activity of their own, can generate exclusive economic zones out to 200 nautical miles. (An exclusive economic zone is a 200-nautical-mile zone extending from a country's coastline within which that country can exercise exclusive sovereign rights to explore for and exploit natural resources, but not full sovereignty.) Rocks, which are defined as being above water at high tide but unable to sustain human habitation or economic activity, only generate a 12-nautical mile territorial sea. UN Convention on the Law of the Sea, "Article 121: Regime of Islands;" UN Convention on the Law of the Sea, "Part 2: Territorial Sea and Contiguous Zone;" and UN Convention on the Law of the Sea, "Part 5: Exclusive Economic Zone."

nal's ruling, President Tsai addressed officers and enlisted personnel on a Taiwan Navy frigate. In President Tsai's remarks she said the ruling "has seriously harmed the rights and interests of our country with respect to the South China Sea islands."¹²³ The ship was originally scheduled to leave the next day for a routine patrol of the South China Sea, but, as part of Taiwan's response to the tribunal's ruling, it set sail the same day.¹²⁴ Taiwan is not a signatory to the UN Convention on the Law of the Sea (UNCLOS), because it lost its seat at the UN before the convention was established. Thus, Taiwan is not bound by the tribunal's decision.

Figure 6: Map of South China Sea



Source: Figure adapted from *Economist*, "Hai-handed," January 13, 2014.

Prior to the ruling, Taiwan had taken some positive steps to clarify its claims in the South China Sea in accordance with UNCLOS and initiated efforts to reduce tensions and establish coordination and cooperation mechanisms with other claimants.¹²⁵ Taiwan has an opportunity to further clarify its position now that the tribunal has clarified the legal status of the features in disputed waters.

Taiwan and the 11-Dash Line

The nine-dash line on Chinese maps of the South China Sea is based on a map with a line containing 11 dashes that was published in 1947 by the government of the Republic of China, which later moved to Taiwan at the end of the Chinese civil war.¹²⁶ There are various explanations of the original meaning of the line. Although the line clearly encompasses the land features that the Taiwan government claims, it is unclear whether it also indicates a claim of sovereignty or jurisdiction over the waters within the line.¹²⁷

One interpretation is offered by Dustin Kuan-Hsiung Wang, a professor in the Graduate Institute of Political Science at National Taiwan Normal University. Dr. Wang discussed the original purpose of the 11-dash or U-shaped line in e-mail correspondence with Commission staff. Dr. Wang wrote: "The meanings of the U-shaped line were probably twofold: one was to demarcate an area of the South China Sea within which the Republic of China claimed all islands. Under this, the claim was not intended to encompass all the water within the lines, but rather, all the land sovereignty within the lines. The other was to express the perception of undecided maritime boundaries between the Republic of China and her neighbors. However, further negotiations were needed between them, therefore the U-shaped line was expressed in (eleven) dashes."¹²⁸

In 1993, the Taiwan government adopted the Policy Guidelines for the South China Sea, which declared that "the South China Sea area within the historic waters limit is the maritime area under the jurisdiction of the Republic of China, where the Republic of China possesses all rights and interests."¹²⁹ The Taiwan government continues to claim the land features in the South China Sea, but its position regarding the waters appears to have changed over time. During the last 20 years, Taipei has gradually stopped using the term "historic waters."¹³⁰ In September 2014, then President Ma said, "The principle that 'sovereignty over land determines ownership of the surrounding waters,' which is set out in [UNCLOS], applies to disputes concerning sovereignty over both land and sea."¹³¹ President Ma's clarification of Taiwan's position that maritime entitlements should be derived from sovereignty over land in accordance with UNCLOS contrasts with China's vague and expansive sovereignty claims to nearly all of the land and sea within its nine-dash line, which encompasses around 90 percent of the South China Sea (the South China Sea encompasses more than 1.4 million square miles of water). The Tsai Administration appears to be continuing this trend away from Taiwan's earlier, more expansive claims, choosing not to mention the dashed line in its response to the arbitral tribunal's ruling.¹³²

The Tsai Administration's policy toward the disputes in the East and South China seas* has been similar so far to that of the Ma Administration, which proposed diplomatic frameworks and signed agreements with other claimants to encourage the setting aside of territorial disputes and promotion of joint resource development. The most recent agreement was reached between Taiwan and the Philippines in November 2015, with the two sides achieving consensus on "avoiding the use of violence or unnecessary force, establishment of an emergency notification system, and establishment of a prompt release mechanism" for fishermen from one country who are detained by the other.¹³³ In March 2016, Taiwan and the Philippines agreed to establish a hotline to notify each other of fishing accidents, to conduct joint inspections of fishing boats, and to exchange inspection reports.¹³⁴ Keeping with the spirit of these previous endeavors, in her inaugural address President Tsai said, "Regarding problems arising in the East China Sea and South China Sea, we propose setting aside disputes so as to enable joint development."¹³⁵ Later, in June, the Tsai Administration announced that it was establishing a maritime affairs cooperation dialogue with the Japanese government to address the dispute between Taiwan fishermen and the Japanese government over rights to fish at Okinotori Atoll, a land feature in the East China Sea that Japan asserts is entitled to a 200 nautical mile exclusive economic zone and that Taiwan and China believe does not have this right, among other issues.¹³⁶

Taiwan Military and Security Issues

Cross-Strait Military Balance

As the Tsai Administration took office, it faced the challenges of a Chinese military modernization program that had dramatically increased despite eight years of enhanced cross-Strait economic, people-to-people, and government ties. Broadly, the cross-Strait military balance has shifted toward China.¹³⁷ The People's Liberation Army (PLA) possesses both a quantitative and a qualitative military advantage over the Taiwan military and is capable of conducting a range of military campaigns against Taiwan.

- The PLA Rocket Force (previously the Second Artillery Force) has approximately 1,200 short-range ballistic missiles and 200–500 ground-launched land-attack cruise missiles.†¹³⁸ According to congressional testimony by U.S. Defense Intelligence Agency Director Lieutenant General Vincent R. Stewart in February 2015, all of China's short-range ballistic missiles are deployed across from Taiwan.¹³⁹ The primary purpose of the majority of these missiles is to deter a move toward formal independence by Taiwan or to destroy Taiwan's ports and air-

*Taiwan is one of three claimants to the Senkaku Islands (known as the Diaoyutai in Taiwan and Diaoyu in China) in the East China Sea. The other claimants are China and Japan.

†Official U.S. and Taiwan estimates of China's number of short-range ballistic missiles and land-attack cruise missiles vary. According to the Taiwan Ministry of National Defense's August 2015 report on China's military power for the Legislative Yuan, China has 1,700 ballistic and cruise missiles, and 1,500 of these missiles are deployed against Taiwan. Senate Armed Services Committee, *Hearing on Worldwide Threats*, written testimony of Vincent R. Stewart, February 26, 2015; Zhu Ming, "Ministry of National Defense: China Keeps 1,500 Missiles Deployed against Taiwan," *Storm Media* (Taiwan), August 31, 2015. Staff translation.

fields should Beijing choose to do so. Although it has not greatly expanded in size since the late 2000s, China's short-range ballistic missile arsenal has become more lethal with the introduction of new missile variants with longer ranges and improved accuracies and warheads.¹⁴⁰

- The PLA Air Force and Navy have about 2,100 combat aircraft, of which approximately 600 are modern.*¹⁴¹ Fewer than 330 of Taiwan's combat aircraft are modern. As part of its efforts to further enhance the capabilities of its fleet of combat aircraft, China signed a contract with Russia to purchase 24 Su-35 fighter aircraft in November 2015.¹⁴² China is also developing the J-20 fifth-generation fighter aircraft and has already tested its fifth and sixth prototypes of the aircraft.¹⁴³
- The PLA Navy has more than 300 surface combatants, submarines, and missile-armed patrol craft, in addition to China's highly capable coast guard and maritime militia.¹⁴⁴ Taiwan, on the other hand, has 90 naval combatants, comprising four submarines† and 86 surface ships.‡¹⁴⁵ As China's naval modernization continues, an increasing percentage of these ships will be modern§ and feature advanced weaponry. For example, the PLA Navy recently has acquired a land-attack capability, as the new LUYANG III-class guided missile destroyer is capable of launching land-attack cruise missiles.¹⁴⁶ In addition, China continues to enhance its amphibious capabilities.¹⁴⁷ Most recently, in January 2016, the PLA Navy launched a new tank landing ship and in March 2016 it commissioned three others.¹⁴⁸ (See Chapter 2, Section 1, "Year in Review: Security and Foreign Affairs," for more information on developments in Chinese military modernization.)

In its preparation for a Taiwan contingency, the PLA conducts a variety of exercises, including antisurface warfare and amphibious exercises, and it has increased the complexity and realism of these exercises.¹⁴⁹ For example, the PLA conducted an amphibious landing exercise in an undisclosed location off of southeastern China in May 2016. The forces involved in the exercise belonged to the 31st Group Army from the Eastern Theater Command, the theater command that is responsible for contingencies involving Taiwan and

* "Modern" combat aircraft are defined as possessing advanced avionics and weapons systems. These aircraft include the J-10, J-11, JH-7, Su-27, and Su-30. For more information on the Commission's definition of "modern" combat aircraft, see U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 309.

† Two of these submarines are only used for training.

‡ Taiwan's coast guard is in the midst of a ten-year shipbuilding program that will bring its forces to 173 ships. Taiwan does not have a maritime militia. Mrityunjay Mazumdar, "Taiwanese Coast Guard Launches OPV amid Ongoing Force Development Programme," *Jane's Defence Weekly*, May 28, 2015.

§ In reference to China's submarine force, the term "modern" is used in this Report to describe a submarine capable of employing antiship cruise missiles or submarine-launched intercontinental ballistic missiles. These include the JIN nuclear ballistic missile submarine, SHANG nuclear attack submarine (SSN), SONG diesel attack submarine (SS), KILO 636 SS, and YUAN diesel air-independent power attack submarine. In reference to China's surface force, the term "modern" is used to describe a surface ship that possesses a multi-mission warfare capability, is armed with more than a short-range air defense capability, and has the ability to embark a helicopter. These include the following: LUHU destroyer (DD), LUHAI DD, LUZHOU guided missile destroyer (DDG), LUYANG I/II/III DDG, SOVREMENNYY I/II DDG, JIANGWEI I/II frigate (FF), JIANGKAI I FF, and JIANGKAI II guided missile frigate. For more information on the Commission's definition of "modern" submarines and surface ships, see U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 300.

Japan. The exercise included amphibious armored assault vehicles, helicopters, and special operations forces attacking a hypothetical enemy beach.¹⁵⁰

China's large defense expenditures are a major challenge for Taiwan. China's defense budget grew by double digits almost every year between 2005 and 2015,* increasing the official defense spending gap to more than \$130 billion. In contrast, Taiwan's defense budget has grown modestly.¹⁵¹ The defense budget submitted by Taiwan's Executive Yuan for 2016 of 321.7 billion New Taiwan Dollars or \$9.8 billion (about 2 percent of GDP) represented an increase of 2.8 percent over the 2015 budget.¹⁵² In 2016, China's announced military budget grew by single digits for the first time since 2010 with an increase of 7.6 percent to 954.35 billion renminbi or \$146.7 billion (1.3 percent of projected GDP).[†]¹⁵³ The slow growth of Taiwan's defense budget was due to a number of factors, including: the improvement in cross-Strait relations that reduced the concern of some in Taiwan regarding China's military threat to Taiwan; growing competition for government resources, particularly from social welfare programs; increasing government debt; partisan political wrangling; and uncertainty about the future of U.S. arms sales to Taiwan, particularly requested sales that Taiwan factors into its budget but are not completed due to delays resulting from unresolved issues on both sides.¹⁵⁴ In the years prior to President Tsai's election, the DPP promised to raise Taiwan's defense budget to 3 percent of GDP.¹⁵⁵ However, in June 2016, Taiwan Premier Lin Chuan said the 2017 defense budget would not reach that level due to financial constraints.¹⁵⁶

Faced with a growing threat from PLA modernization, Taiwan has sought to enhance its military capabilities in part by indigenously developing platforms and weapons systems. Advanced anti-ship cruise missiles, air defense missiles, and fast attack and stealthy catamaran-style patrol ships are among the newest platforms and weapons systems that Taiwan has produced. Some of the developments in Taiwan's procurement of domestic military equipment over the past year include the following:

- *Missile corvette*: Taiwan's TUO JIANG-class catamaran-style missile corvette is projected to enter serial production in 2018.¹⁵⁷ Taiwan commissioned the first ship in this class in March 2015, and after identifying several areas in which the ship needed improvement, has since created a new design for serial production.¹⁵⁸ Taiwan may build up to 11 more ships in the TUO JIANG-class. The new corvette has stealth features and better range, endurance, and sea-keeping ability than Taiwan's other patrol ships, and it is equipped with 16 antiship cruise missiles.¹⁵⁹ It also has two torpedo tubes and a towed sonar array.¹⁶⁰ These features will enhance the survivability and lethality of Taiwan's antisurface and antisubmarine forces in a potential cross-Strait conflict.¹⁶¹

* This measurement is according to China's announced defense budgets, not actual aggregate spending. China's announced budget omits major defense-related expenditures, such as purchases of advanced weapons, R&D programs, and local government support to the PLA.

† See Chapter 2, Section 1, "Year in Review: Security and Foreign Affairs," for more information on China's defense budget.

- *Naval combat system:* Taiwan is developing the Hsun Lien combat system with which it will equip ships across the Taiwan Navy.¹⁶² With Hsun Lien, Taiwan seeks to develop a combat system that can track and engage numerous targets in various domains in order to enhance Taiwan's fleet air defense against China's antiship cruise missiles as well as the Taiwan Navy's ability to attack the PLA Navy's surface combatants and submarines.¹⁶³
- *Submarines:* Taiwan is moving ahead with its plan to indigenously build submarines with foreign assistance. The Tsai Administration has expressed hope that the U.S. government will assist with this process.¹⁶⁴ Taiwan has begun to design the indigenous submarine, a stage it hopes to complete by 2019, and announced the opening of its development center.¹⁶⁵ Taiwan currently has four submarines; two are operational Zwaardvis-class submarines and two are decommissioned U.S. Navy GUPPY-class submarines (which have undergone upgrades since the 1940s) used only for training.¹⁶⁶ The Taiwan Navy's already limited ability to conduct antisurface warfare against China's expanding fleet of modern surface ships will continue to erode as Taiwan's submarine force ages.

Taiwan also seeks to enhance its military capabilities through procurement of military platforms and weapons systems from overseas. Select military equipment Taiwan is acquiring from the United States* includes the following (see also the discussion on arms sales, military-to-military contacts, and U.S.-Taiwan defense relations in "U.S.-Taiwan Relations," later in this section):

- *F-16 fighter upgrade:* Taiwan and the United States continue to move forward with the upgrade of Taiwan's 144 F-16 A/B fighter aircraft. Following the initial flight in October 2015 of the first two upgraded fighters, which were built by Lockheed Martin, the chairman of the board of Taiwan's Aerospace Industrial Development Corporation announced in May 2016 that the company's facility in Taiwan—where the upgrade for the rest of the fleet will occur—is projected to be completed by the end of 2016, and the upgrade will begin in 2017.¹⁶⁷ The most important part of the upgrade is the installation of active electronically scanned array scalable agile beam radar made by Northrup Grumman.¹⁶⁸ This radar will enable Taiwan's F-16s to better detect China's advanced combat aircraft.¹⁶⁹
- *P-3C Orion maritime patrol aircraft:* By July 2016, Taiwan was projected to receive the remaining two of 12 P-3C antisubmarine aircraft it purchased from the United States in 2007 (they had not been delivered at the time this Report went to print).¹⁷⁰ The P-3Cs, which began arriving in 2013, will replace the Taiwan Air Force's fleet of 11 S-2T antisubmarine aircraft that have been in service for over 40 years.¹⁷¹ The P-3C will increase the capabilities and endurance of the Taiwan

*Although the United States is Taiwan's most important source of advanced military equipment, companies based in Germany and Singapore, among other countries, supplied technology for Taiwan's TUO JIANG-class missile corvette. Wendell Minnick, "Taiwan Navy Accepts New Catamaran," *Defense News*, December 31, 2014.

military's fixed-wing maritime patrol aircraft force, improving Taiwan's ability to perform antisubmarine warfare and intelligence, surveillance, and reconnaissance missions.¹⁷²

Defense Policy and Strategy under the Tsai Administration

During its first year in office, the Tsai Administration further articulated its defense policies and defense strategy, which will build on and refine the policy platform expressed by the DPP and President Tsai in recent years and during her campaign.* In a May 2015 policy paper, the DPP announced that a DPP administration would initiate an open defense policy discussion and issue its own quadrennial defense review within ten months of taking office.¹⁷³ Between June 2013 and May 2015, the New Frontier Foundation, the DPP's think tank, issued 12 defense-related policy papers that call for: building and acquiring asymmetric platforms; creating a new military service for cybersecurity and electronic warfare; bolstering missile defense capacity; building improved combat survivability against missile strikes; restructuring the ground force into specialized rapid response units; and maintaining capabilities in air and sea control.¹⁷⁴ In May 2016, following President Tsai's inauguration, Minister of Defense Feng Shih-kuan told the Foreign Affairs and National Defense Committee of the Legislative Yuan that the Administration would move forward with establishing the new cyber service of the military.¹⁷⁵

Support for Taiwan's defense industry and indigenous R&D are major components of President Tsai's defense policy. Three of the New Frontier Foundation's 12 defense policy papers focus on these issues and President Tsai held a press conference in October 2015 to discuss her defense industrial policy. During the press conference she outlined the three areas of domestic defense technology on which her administration would focus its efforts: aviation and aerospace, shipbuilding, and cybersecurity. She specifically called for the development of a new trainer aircraft and next-generation fighter aircraft and pledged that Taiwan would begin the development of a prototype of an indigenous submarine in 2016, with a plan for the first boat to be launched in ten years.¹⁷⁶ Regarding funding for such programs, in addition to the DPP's pledge to restore defense spending to 3 percent of GDP annually, one of the DPP's policy papers advocated for 70 percent of all new defense spending to go toward "military investments," including procurement of weapons and equipment, defense construction, and R&D.¹⁷⁷ Another policy paper also set the goal that by 2020 no less than 60 percent of these military investments will be spent on indigenous R&D.¹⁷⁸

President Tsai will continue Taiwan's building of an all-volunteer force, which began under former President Ma. During her campaign she advocated for several changes to military personnel policy and voiced support for slowing the transition away from con-

*President Tsai faced an early challenge in her tenure as commander-in-chief of the Taiwan military when a Taiwan Navy patrol ship accidentally launched an antiship cruise missile during an exercise and the missile struck a Taiwan fishing boat, killing the captain and injuring three crew members. The subsequent investigation found that procedural errors by crew members led to the accidental launch of the missile. Chen Wei-han, "MND Explains Cause of Missile Incident," *Taipei Times*, August 30, 2016.

scription.¹⁷⁹ Taiwan's transition to an all-volunteer force has been far more costly than expected, increasing budgetary pressure on R&D as well as operations and maintenance funding.¹⁸⁰ To find additional savings, Taiwan in 2013 decided to reduce its active duty force from 275,000 to 215,000 by 2015,¹⁸¹ and had planned to reduce the force to 170,000 by the end of 2019.¹⁸² The Legislative Yuan passed a resolution to suspend the latter reduction.¹⁸³ Taiwan has struggled with recruitment and retention, and despite recent improvements, the Ministry of National Defense's projection for personnel at the end of 2016 was still below the force level it assessed to be necessary to meet Taiwan's defense needs.¹⁸⁴ Therefore, the ministry decided to conscript approximately 23,100 men in 2016 for one year of compulsory active duty service.¹⁸⁵

Taiwan Military Training and Activities

The Taiwan military routinely conducts a range of exercises to maintain combat readiness; integrate new weapons systems and tactics; test and improve its capabilities; and demonstrate to the Taiwan people, China, and others that it has a credible deterrence capability. In 2016, select major exercises and activities included the following:

- *Antisubmarine exercise:* In January 2016 the Taiwan Navy conducted antisubmarine reconnaissance and escort exercises involving an antisubmarine helicopter, a frigate, a destroyer, a replenishment vessel, and a missile patrol ship.¹⁸⁶
- *Han Kuang exercises:* Taiwan's annual Han Kuang exercises began in April with a five-day, computer-assisted command post exercise, a combat simulation exercise in which commanders, staff, and communications personnel participate.¹⁸⁷ Live-fire exercises were held in August and were scheduled to be held again between October and November.¹⁸⁸ The live-fire exercises in August included information and electronic warfare, joint air defense, counter airborne and amphibious landing, joint antisubmarine warfare, and reserve mobilization, among other missions.¹⁸⁹ The exercises were held at many locations across Taiwan, including offshore islands. For the first time, civilian information technology specialists were recruited to participate in the cyber defense and attack portions of the exercises.¹⁹⁰

China's Espionage against Taiwan

China's aggressive intelligence activities against Taiwan pose a threat to Taiwan's security and to the security of U.S. military information and equipment to which Taiwan has access. (See Chapter 2, Section 3, "Chinese Intelligence Services and Espionage Threats to the United States," for more information on Chinese intelligence operations.)

These activities showed no sign of abating during the eight years of cross-Strait rapprochement.¹⁹¹ Many cases of Chinese espionage against Taiwan have come to light in recent years.¹⁹² According to a report by Taiwan's National Security Bureau, in 2014 there were 15 cases of alleged spying.¹⁹³ In his written testimony for the Com-

mission's hearing on Chinese intelligence services and espionage threats to the United States, David Major, the founder and president of CI Centre, presented a list with the names of 56 individuals who were arrested or indicted in Taiwan due to their alleged involvement in Chinese espionage plots over the past 14 years. According to Mr. Major, these were plots to "accrue the most significant technology and intelligence from [Taiwan's] military and all three intelligence services. Much of this technology was developed by the U.S. defense community in the United States and sold to Taiwan. Justifiable concerns about the security of U.S. defense systems sold to Taiwan is a byproduct of this espionage activity."¹⁹⁴

The increased travel between Taiwan and China that resulted from the warming of cross-Strait ties under the Ma Administration increased Taiwan's vulnerability to espionage by expanding China's opportunities for intelligence operations against Taiwan targets in both Taiwan and China. With its loosening of regulations on Chinese tourists, Taiwan has allowed individuals to travel independently without a tour group. Among other espionage risks, this development has made ensuring the security of Taiwan defense installations more difficult. Taiwan's *Liberty Times* reported that in October 2015 many Chinese independent travelers were riding electric scooters and bicycles taking pictures of the Jioupeng Military Base, where Taiwan tests missiles.¹⁹⁵

In the face of the Chinese espionage threat, the Taiwan military has implemented measures to impede Chinese intelligence activities. Peter Mattis, China fellow at the Jamestown Foundation, writes that "Taiwan has made several substantial efforts to improve security—including trip reporting and routine polygraphs for personnel with sensitive access as well as boosting its counterintelligence staff—and serious offenders can, but not always, receive heavy prison sentences."¹⁹⁶

William Stanton, former director of the American Institute in Taiwan and current director of Taiwan's National Tsinghua University's Center for Asia Policy, said in 2013 that cases of Chinese espionage against Taiwan "have been harmful not only because of the potential loss of unknown quantities of classified information, but also because their success and frequency serves to undermine U.S. confidence in security cooperation with Taiwan."¹⁹⁷ However, Mr. Major testified to the Commission that "if the USA begins to slowdown or stop the transfer of needed technology and information with Taiwan for fear of espionage loss then the PRC wins and Taiwan is doomed."¹⁹⁸ He noted that "during the period 2001 to 2016 154 individuals arrested in the USA were involved in providing sensitive information and/or technology to entities in China. Thus PRC 'espionage' is a problem and reality for both [Taiwan], the USA and the world as a whole."¹⁹⁹

Beyond Chinese espionage, Taiwan faces the challenge of Chinese political warfare. A scholar told the Commission that China conducts influence operations against Taiwan through academic institutions, cultural groups, and artistic organizations.²⁰⁰ Chinese political warfare not only seeks to affect views within Taiwan but also views of Taiwan held by people in other countries. For example, Mr. Cole wrote that some of the ways that China conducts political warfare against Taiwan are through PLA "officers at inter-

national conferences (if they speak good English, they are likely political warfare officers) and through comments to the media (including specialized publications such as *Defense News*) portraying the Taiwanese military apparatus as incompetent, careless, and/or entirely penetrated by Chinese intelligence.”²⁰¹ These activities are part of a longstanding and extensive effort by Beijing that is ultimately aimed at subjugating Taiwan under Beijing’s rule by influencing views of China within Taiwan, undermining Taiwan’s status in the international community, and sowing distrust between Washington and Taipei.²⁰²

U.S.-Taiwan Relations

Political Relations in the Tsai Ing-wen Era

U.S.-Taiwan relations are on track to expand on the growth in cooperation and mutual trust that developed during the Ma Administration. During her speech in Washington, DC in 2015, now President Tsai emphasized that Taiwan will be a reliable partner of the United States, and in an op-ed published by the *Wall Street Journal* during her trip she described the United States as “Taiwan’s most important strategic partner” and advocated for “broadening multi-faceted cooperation with the [United States].”²⁰³ Later, in September 2015, she explained that Taiwan’s relationship with the United States and other like-minded democracies will be based on “mutual trust, respect, and communication.”²⁰⁴ Immediately following President Tsai’s election, the U.S. government praised Taiwan’s democracy and expressed its anticipation for partnering with the Tsai Administration and its appreciation to then President Ma for his contribution to strengthening U.S.-Taiwan relations.²⁰⁵ In the following months, other U.S. officials expressed praise for Taiwan’s democracy.²⁰⁶ In Congressional testimony in February on U.S.-Taiwan relations, Deputy Assistant Secretary of State in the Bureau of East Asian and Pacific Affairs Susan Thornton said, “The people on Taiwan have built a prosperous, free, and orderly society with strong institutions, worthy of emulation and envy. . . . Last month’s free and fair elections were yet another victory for Taiwan’s vibrant democracy.”²⁰⁷ Prior to President Tsai’s inauguration, Deputy Assistant Secretary Thornton also expressed support for President Tsai’s approach to cross-Strait relations. In an interview with Taiwan’s Central News Agency she said, “I think there has been a very good political basis laid for the continuation of cross-strait exchanges, as President-elect Tsai also has mentioned.”²⁰⁸

Trade and Investment

President Tsai’s emphasis on the importance of Taiwan’s relations with the United States, on strengthening economic partnerships beyond China, and on Taiwan joining TPP almost certainly will help to deepen U.S.-Taiwan economic ties during her administration.

In 2015, Taiwan became the United States’ ninth largest trading partner, surpassing India, Italy, and Brazil.²⁰⁹ Bilateral trade to-

taled \$66.6 billion, a 1.2 percent decline since 2014.*²¹⁰ The United States exported \$25.9 billion in goods to Taiwan and imported \$40.7 billion in goods from Taiwan.²¹¹ Taiwan is also the seventh-largest importer of U.S. agricultural products.²¹² The United States remained ahead of Japan as Taiwan's second largest trading partner.[†]²¹³ The United States is Taiwan's third largest export market and source of imports.²¹⁴ The top U.S. exports to Taiwan include industrial machinery, semiconductors, civilian aircraft, and military equipment.²¹⁵ The top U.S. imports from Taiwan include semiconductors, telecommunications equipment, vehicle parts, cellular phones, and computer accessories.²¹⁶ In addition, the United States is Taiwan's largest source of FDI.²¹⁷ Taiwan is the 29th largest investor in the United States in terms of total stock of FDI, and Taiwan companies employed more than 12,000 U.S. workers as of 2013. Taiwan is also a major participant in the U.S. Department of Commerce's SelectUSA Investment Summit.[‡]²¹⁸

Although U.S.-Taiwan economic ties remain strong, substantive progress in some areas of ongoing trade and investment negotiations slowed in recent years.²¹⁹ Both sides discuss bilateral economic issues primarily through a Trade and Investment Framework Agreement (TIFA), established in 1994. The last TIFA meeting was held in October 2016, during which the United States and Taiwan discussed a range of bilateral economic issues, including agriculture, pharmaceuticals and medical devices, intellectual property rights protection, trade barriers, and investment.²²⁰ However, the two sides have yet to resolve a dispute over U.S. pork imports, one of the most contentious issues in the economic relationship.²²¹ Although Taiwan loosened some restrictions on residual levels of ractopamine § in U.S. beef imports in 2012, it maintains these restrictions on pork imports. Several key roadblocks to overturning restrictions include pressure from Taiwan's pork industry and Taiwan citizens' aversion to the use of ractopamine in pork production.²²² The Tsai Administration has not announced whether or not it will remove the restrictions.

One area with great potential for expanding the scope of U.S.-Taiwan economic relations is cooperation in the information and communications technology (ICT) industry. According to Lotta Danielsson, vice president of the U.S.-Taiwan Business Council, who spoke at an event at the Center for Strategic and International Studies in August 2016, Taiwan has evolved from a purely

*Trade statistics from the U.S. Census Bureau in this section include re-exports and re-imports.

†Trade statistics from Taiwan's Bureau of Foreign Trade in this section exclude re-exports and re-imports.

‡The U.S. Department of Commerce's SelectUSA program helps foreign companies invest in the United States and assists U.S. economic development organizations in attracting FDI. The annual SelectUSA Investment Summit is the program's most high-profile conference for promoting FDI in the United States. U.S. Department of Commerce, "SelectUSA."

§ Taiwan banned imports of U.S. beef because Taiwan citizens were concerned safeguards to prevent mad cow disease were insufficient and because U.S. farmers' use of ractopamine, a controversial feed additive that promotes leanness in meat. Ractopamine is widely used in U.S. pork and beef production, but Taiwan, the EU, and China have banned the use of ractopamine based on health and safety concerns. The issue was partially resolved when the Taiwan government established a maximum residue limit for ractopamine in beef in September 2012, allowing U.S. beef exports greater access to Taiwan. In 2013, the U.S. became Taiwan's largest beef supplier by value. J.R., "Gored," *Banyan Asia (Economist blog)*, March 8, 2012; Shirley Kan and Wayne Morrison, "U.S.-Taiwan Relationship: Overview of Policy Issues" *Congressional Research Service*, April 22, 2014, 34-36; and Cleo Fu and Emily Scott, "U.S. Beef Exports to Taiwan Realize 2013 as Record Year," *USDA Foreign Agricultural Service*, March 31, 2014.

trade-based partner to an innovation partner of the United States.²²³ Cooperation in R&D between the United States and Taiwan is strong. U.S. companies HP, DuPont, and Dell have R&D centers in Taiwan; and Google and IBM have cloud computing centers in Taiwan.²²⁴ The U.S. and Taiwan governments hosted the inaugural U.S.-Taiwan Digital Economy Forum in December 2015. In an upcoming meeting later this year, both sides will continue to focus on bilateral collaboration on cross-border ICT applications, legal and regulatory frameworks, the expansion of global ICT connectivity, data privacy, and intellectual property protection.²²⁵

Military and Security Cooperation

U.S.-Taiwan security cooperation includes arms sales, training, advising, exchanges, and equipment maintenance.²²⁶ This partnership helps Taiwan enhance its ability to deter and, if necessary, defend against an attack from the Chinese military.

On December 16, 2015, the U.S. Department of State notified Congress* that it had approved the potential sale of \$1.83 billion in arms to Taiwan,²²⁷ including the following items: (1) two refurbished and upgraded OLIVER HAZARD PERRY-class guided-missile frigates; (2) AAV-7 amphibious assault vehicles; (3) Javelin antitank missiles; (4) BGM-71F tube-launched, optically-tracked, wireless-guided (TOW) antitank missiles; (5) man-portable Stinger missiles; (6) MK-15 Phalanx close-in weapons systems (CIWS); (7) Multifunctional Information Distribution System Low Volume Terminals (MIDS/LVT-1) and Joint Tactical Information Distribution System (JTIDS) data communications support; and (8) Taiwan Advanced Tactical Data Link System (TATDLS) and Link-11 communication systems integration (see Table 1).²²⁸

This most recent notification brings the value of the Obama Administration's total notifications of Taiwan arms sales to Congress to over \$14 billion.²²⁹ Despite the large value of arms sales notifications, the Administration's prior notification occurred more than four years before in 2011. The package also did not include advanced fighter aircraft and assistance to Taiwan's indigenous submarine program, in which Taiwan has expressed interest. Although the time period between notifications to Congress was almost certainly affected by concern within the executive branch about the impact of arms sales to Taiwan on U.S.-China relations,²³⁰ budgetary constraints in Taiwan also likely were a factor. Ongoing payments for U.S. weapons that were notified previously likely put pressure on Taiwan's budget.²³¹

*The executive branch is required to notify Congress of arms sales through the foreign military sales process that meet or exceed the following values: \$14 million in major defense equipment, \$50 million in defense articles or services, and \$200 million in design and construction services. Paul K. Kerr, "Arms Sales: Congressional Review Process," *Congressional Research Service*, April 19, 2016.

Table 1: 2015 U.S. Arms Package and Its Utility in a Cross-Strait Conflict

Platforms, Weapons, and Systems	Utility in a Cross-Strait Conflict
Two PERRY-class guided missile frigates (refurbished)	These general-purpose escort ships, which will be equipped for antisubmarine, surface-to-surface, and surface-to-air operations ²³² would help Taiwan protect other ships against PLA submarines, surface combatants, and aircraft.
36 AAV-7 Amphibious Assault Vehicles	The AAV-7s will strengthen the expeditionary capability and mobility ²³³ of the Taiwan Marine Corps and would help Taiwan deploy troops along Taiwan's coastline in the event of an invasion.
208 Javelin antitank missiles	These portable missiles ²³⁴ would help Taiwan defend against PLA tanks, mechanized infantry, and helicopters.
769 BGM-71F TOW 2B-Aero antitank missiles	With a range of 4.5 kilometers (3 miles), ²³⁵ these missiles would help Taiwan engage PLA tanks and mechanized infantry at a distance.
250 Stinger surface-to-air missiles	These missiles, with a range of five miles, ²³⁶ would help Taiwan engage PLA aircraft approaching or over Taiwan.
13 MK-15 Phalanx CIWS guns	The Phalanx CIWS is a close-range point-defense system ²³⁷ and would help to defend Taiwan's surface combatants against PLA missiles and aircraft.
Support for MIDS/LVT-1 and JTIDS	MIDS—a command, control, communications, computers, and intelligence system—and JTIDS—a radio communications system ²³⁸ —would enhance communication and coordination across the Taiwan military during a cross-Strait conflict.
TATDLS and Link-11 Integration	TATDLS is a beyond line-of-sight datalink system that would enhance communication, data sharing, and integration between Taiwan's surface ships. ²³⁹

Source: Information about the number and type of each weapons system is compiled from U.S. Defense Security Cooperation Agency, "Major Arms Sales," December 16, 2015.

The items in the December 2015 announcement will provide modest improvements to Taiwan's military capabilities.²⁴⁰ Mr. Cole wrote about the package, "Political symbolism aside, this week's arms package does have some defensive value."²⁴¹ Moreover, the announcement sent a message to Beijing and Taipei that the United States remains committed to Taiwan's defense.

Military-to-military contacts between the United States and Taiwan have dramatically increased in recent years. According to Deputy Assistant Secretary Thornton, the number of annual "security cooperation events" with Taiwan has nearly doubled in recent years.²⁴² Furthermore, the number of U.S. Department of Defense personnel visiting Taiwan increased from around 1,500 in 2012 to more than 3,200 in 2015.²⁴³ Among other areas of training, the United States provides training to Taiwan fighter pilots, special operations personnel, and rapid runway repair personnel, and Taiwan military personnel study at U.S. military institutions.²⁴⁴

Nevertheless, the U.S. government practice of limiting the highest rank of U.S. military personnel who can visit Taiwan to colonels and captains (O6 level) prevents the most senior U.S. officers from gaining firsthand knowledge of the Taiwan military and the operational environment in a potential cross-Strait conflict.*²⁴⁵ In addition, Taiwan is not invited to a number of major U.S.-led military exercises, such as the biennial Rim of the Pacific (RIMPAC) exercise—which included China in 2014 and 2016—and the Red Flag air-to-air combat training exercise, and other security exercises, such as the biennial cybersecurity exercise Cyber Storm. Participating in such exercises, even as an observer, could help Taiwan enhance its ability to defend itself and provide the Taiwan military with more opportunities to interact with other militaries.

Other Areas of Cooperation

Beyond commercial and security ties, U.S.-Taiwan relations span many other areas, including environmental protection and humanitarian assistance and disaster relief.²⁴⁶ One of the most dynamic U.S.-Taiwan initiatives is the Global Cooperation and Training Framework, which the two countries established in June 2015. Through this initiative, the United States and Taiwan jointly train experts from the Asia Pacific in areas including the empowerment of women, public health, energy, and information and communication technology.²⁴⁷ Taiwan has already hosted several programs under the initiative, such as a training course for laboratory professionals on diagnosing, preventing, and responding to Middle East Respiratory Syndrome, and a training course for government officials and health care professionals on the prevention and control of dengue fever.²⁴⁸

Another area where the United States and Taiwan are collaborating is cybersecurity. In May, a delegation led by Assistant Secretary of Commerce for Industry and Analysis Marcus Jadotte visited Taiwan to attend the first-ever U.S.-Taiwan Cyber Security Forum and advance cybersecurity cooperation.²⁴⁹ Assistant Secretary Jadotte and the Taiwan Computer Association signed a statement of intent, which the assistant secretary said “calls for both sides to explore ways to work together to counter cybersecurity risks and make the Internet a safer place for individuals and businesses.”²⁵⁰ The delegation included representatives of companies such as Cisco Systems and Lockheed Martin.²⁵¹

Taiwan’s Role in the U.S. Rebalance to Asia

In May 2015, the Obama Administration provided its most detailed explanation of Taiwan’s role in the U.S. Rebalance to Asia

*The versions of the National Defense Authorization Act for Fiscal Year 2017 passed by the Senate (S. 2943) and the House (H.R. 4909) include a sense of Congress that “the Secretary of Defense should conduct a program of senior military exchanges between the United States and Taiwan that have the objective of improving military-to-military relations and defense cooperation between the United States and Taiwan.” The exchanges would occur at least once a year in the United States and in Taiwan and would involve active-duty general or flag officers and civilian Department of Defense officials at the level of assistant secretary of defense or above. The bill was still in conference negotiations at the time of the publication of this Report. Joe Gould, “Congress Girds for Defense Spending, Policy Fights,” *Defense News*, September 2, 2016; National Defense Authorization Act for Fiscal Year 2017, S. 2943, 114th Cong., 2nd Sess., July 7, 2016; and National Defense Authorization Act for Fiscal Year 2017, H.R. 4909, 114th Cong., 2nd Sess., May 26, 2016.

strategy. (See Chapter 4, “China and the U.S. Rebalance to Asia,” for more information on the Rebalance to Asia strategy.) U.S. Secretary of State John Kerry, in a written response to a question from the House Foreign Affairs Committee, described deepening U.S.-Taiwan engagement on trade and investment, cooperating on regional economic integration through the Asia Pacific Economic Cooperation forum, and making available U.S. defense articles and services to Taiwan. He said, “Collectively, these activities demonstrate our continued commitment to Taiwan’s peace, security, and prosperity as part of the U.S. rebalance.”²⁵² Prior to Secretary of State Kerry’s letter, other U.S. officials have mentioned Taiwan’s role in the Rebalance but have not elaborated about how Taiwan fits into the strategy.²⁵³ This lack of clarity could be due to concerns about the impact on U.S.-China relations of openly emphasizing Taiwan in the strategy.

The Tsai Administration is striving for Taiwan to be included in the second round of negotiations of TPP, which has been described by Obama Administration officials as the central economic component of the Rebalance strategy. In her meeting with the delegation led by Assistant Secretary Jadotte in May, President Tsai said, “The 12 TPP member states account for 37 percent of Taiwan’s total trade. It’s crucial for us to join TPP.”²⁵⁴ Some analysts have advocated for the United States to support Taiwan’s bid to join TPP.²⁵⁵ A place in TPP would enable Taiwan to participate more fully in regional economic integration and expand market access for its exports,²⁵⁶ supporting its efforts to diversify its export markets. One business representative in Taiwan told the Commission that joining TPP is a crucial step toward ensuring Taiwan maintains its economic competitiveness.²⁵⁷ For the United States, Taiwan’s participation in TPP would allow U.S. companies greater access to Taiwan’s economy,²⁵⁸ which ranks 22nd in the world in terms of GDP by purchasing power parity and is larger than the economies of half of the current TPP member countries.²⁵⁹ In addition, Dr. Bush and Joshua Meltzer, senior fellow in global economy and development at the Brookings Institution, explained that by including Taiwan, TPP would include an “important driver of trade and investment in the Asia Pacific region.”²⁶⁰ Scholars at the Chung-Hua Institute for Economic Research in Taiwan told the Commission that even if Taiwan is unable to join TPP, carrying out the economic reforms necessary to meet TPP’s standards, including a better regulatory environment and increased government transparency, will benefit Taiwan.²⁶¹ Another scholar added that these reforms also would improve Taiwan’s prospects for a free trade agreement with the United States.²⁶²

Other ideas raised in recent years for enhancing U.S. engagement with Taiwan include increasing science and technology and defense-industrial cooperation, expanding U.S.-Taiwan joint training programs in various fields for experts from third countries, collaborating with the Taiwan military to enhance maritime domain awareness in the Pacific Ocean, and inviting Taiwan to participate in U.S.-led multilateral military exercises.²⁶³ In February 2016, Randall Schriver, president and chief executive officer of the Project 2049 Institute, in testimony to Congress stated, “The Taiwanese economy has long relied upon maintaining a technological

comparative advantage, and sustaining this advantage is an important driving force shaping the future of the region. . . . The U.S. and Taiwan could deepen and broaden their economic relationship by expanding [science and technology] cooperation. Additionally, [science and technology] cooperation could help Taiwan maintain its technological advantage and produce mutually beneficial innovations.”²⁶⁴ In March, at an event at the George Washington University, Mr. Shriver suggested that the United States consider expanding the U.S.-Taiwan Global Cooperation and Training Framework to include other like-minded countries, such as Australia, Japan, and India, among the trainers and to include training in areas such as antipiracy and counterterrorism.²⁶⁵

Scholars in Taiwan told the Commission that humanitarian assistance and disaster relief and search and rescue are areas with great potential for expanded U.S.-Taiwan cooperation. They said that Taiwan has very capable humanitarian assistance and disaster relief and search and rescue forces and pointed out that the second-largest humanitarian assistance and disaster relief training center in East Asia is in Taiwan.²⁶⁶ One example of U.S.-Taiwan cooperation in humanitarian assistance and disaster relief occurred in 2010 when a Taiwan Air Force transport aircraft landed in the United States to refuel during its flight to deliver relief supplies to Haiti following a major earthquake.²⁶⁷ The previous year, after Typhoon Morakot hit Taiwan, the U.S. military assisted with the recovery effort by transporting construction vehicles and equipment and relief supplies to the affected areas.²⁶⁸

Implications for the United States

Taiwan’s presidential and legislative elections in January 2016 once again demonstrated the vibrancy of its democracy and the common values that are one of the pillars of U.S.-Taiwan relations. The elections also demonstrated that Taiwan is a model for other countries in the region and around the world. As Kurt Tong, principal deputy assistant secretary in the Department of State’s Bureau of Economic and Business Affairs, explained in a speech about Taiwan in March 2016, “Taiwan’s evolution into a robust democracy, and a strong free market economy, with a vibrant civil society, make it a model for others.”²⁶⁹

Taiwan’s robust democracy, civil society, and technology sector, and its vast expertise and experience in various areas, such as humanitarian assistance and disaster relief, make it a strong partner for the United States in facing global challenges. As the United States seeks to engage in capacity building in the Asia Pacific, Taiwan is assisting with these efforts through the Global Cooperation and Training Framework.

Taiwan also is a contributor to regional peace and stability through its efforts to promote the setting aside of territorial disputes and joint resource development in the East and South China seas. Two examples of this policy are the fisheries agreements that Taiwan signed in recent years with Japan and the Philippines, respectively. Other actions by Taiwan that support U.S. objectives of rule of law and peaceful resolution of disputes include taking steps

to clarify its claims in the South China Sea and expressing support for multilateral negotiations on the South China Sea.²⁷⁰

Going forward, in this new period of cross-Strait relations following the election of President Tsai, whether tension between Taiwan and China will increase is unclear. Should tension grow significantly, the United States may have to devote more attention to cross-Strait relations. Furthermore, Ms. Glaser writes that “a spike in cross-Strait tension increases the risk of a wider conflict through political and even military escalation, which could draw in the United States.”²⁷¹ Beijing further limited Taiwan’s participation in international organizations, which is not in U.S. interests. Taiwan has much to contribute to the international community in areas including aviation safety, public health and combating the spread of infectious diseases, and law enforcement and fighting transnational crime.²⁷²

The U.S.-Taiwan security partnership contributes to regional peace and stability by enhancing Taiwan’s ability to deter an attack by the Chinese military. However, China’s military modernization presents a significant challenge both to Taiwan’s ability to defend itself and to the United States’ ability to intervene effectively in a cross-Strait conflict should it choose to do so. It also improves China’s ability to use the threat of military force to coerce Taiwan into making political concessions.

Conclusions

- In 2016, Taiwan held historic elections, in which Tsai Ing-wen of the Democratic Progressive Party (DPP), was elected Taiwan’s first female president and the DPP gained an absolute legislative majority for the first time. Despite President Tsai’s pragmatic cross-Strait policy focused on maintaining the status quo, Beijing appears to remain skeptical of President Tsai and has applied pressure on her administration with various statements and actions.
- China remains Taiwan’s largest trading partner, biggest export market, and top source of imports. However, cross-Strait trade has slowed, in large part due to the negative impact of China’s economic slowdown and the emergence of Chinese competitors on Taiwan’s information technology exports to China, which underscores the vulnerability of Taiwan’s export-dependent economy to developments in China.
- Taiwan’s ability to participate in the international community is not only crucial to the wellbeing of its people but is also key to Taiwan’s ability to contribute to international safety, security, and prosperity. Beijing restricts Taiwan’s participation in international organizations and has placed additional limitations on Taiwan’s international activities since President Tsai was elected. Should Beijing seek to further increase pressure on Taipei, it may take additional steps to restrict Taiwan’s international space, including by enticing some countries with which Taiwan has diplomatic relations to cut ties and establish diplomatic relations with China.

- China's military modernization remains focused on preparing for a range of Taiwan contingencies, and the advancement in the capabilities of the People's Liberation Army (PLA) presents a significant challenge to Taiwan's ability to defend itself and the U.S. military's ability to effectively intervene in a cross-Strait conflict. Taiwan is engaged in a robust program to enhance its defensive capabilities through its domestic defense industrial production, the procurement of U.S. weapons systems, and its transition to an all-volunteer force, efforts which the Tsai Administration seeks to refine and build upon. However, the cross-Strait military balance has shifted toward China, and the PLA possesses both a quantitative and a qualitative military advantage over the Taiwan military.
- U.S.-Taiwan relations have transitioned smoothly from the Ma Administration to the Tsai Administration and continue to strengthen and expand in scope. Security cooperation remains a robust area of the U.S.-Taiwan relationship.

RECOMMENDATIONS

China and Taiwan

The Commission recommends:

- Members of Congress and Congressional staff seek opportunities to advance U.S.-Taiwan economic, political, and security relations, support Taiwan's participation in international organizations, and draw attention to Taiwan's democratic achievements and contributions to the international community.
- Congress urge the executive branch to make available to Taiwan, consistent with the Taiwan Relations Act, defense articles and services required to address the continuing shift in the cross-Strait military balance toward China.
- Congress direct the U.S. Department of State to reexamine its policy guidelines on reciprocal visits by senior U.S. and Taiwan military officers and civilian officials with the aim of increasing high-level exchanges.
- Congress request briefings by the Office of the U.S. Trade Representative (USTR) on the status of the Trade and Investment Framework Agreement negotiations with Taiwan and direct the USTR to identify enhanced negotiating procedures to resolve outstanding issues and ensure an accelerated path to conclude such talks.

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SECTION 3: CHINA AND HONG KONG

Introduction

The year 2016 saw notable developments in Hong Kong politics and society. Many of these events were indicative of mainland China's increasing efforts to control political life and the flow of information, and Hong Kong citizens' resistance to them. This was illustrated most clearly in the September legislative election, which saw a record voter turnout and prodemocracy candidates gaining three seats, despite Beijing's efforts to undermine those running on prodemocracy or pro-independence platforms. The election outcome was influenced in part by the emergence of a small but vocal political minority supporting self-determination (and among some, outright independence). The election took place against the backdrop of an alarming rise in mainland interference in Hong Kong. One example of this was the apparent abduction and detention of five Hong Kong booksellers by mainland authorities and the consequent chilling effect on the publication and distribution of politically sensitive books and books that have been banned in the Mainland. This incident has threatened the maintenance of the "one country, two systems" framework* and led some observers to question Hong Kong's long-standing status as a leading global financial hub.

In addition to these developments, this section examines Hong Kong's economic and security ties with the Mainland, and the implications of these trends for the United States. It is based on open source research and analysis and consultations with U.S. and foreign nongovernmental experts.

Hong Kong's Changing Political Landscape

Background

As previous Commission reports have illustrated, Hong Kong's politics and governance since the United Kingdom's (UK) handover of Hong Kong to Beijing in 1997 have been characterized by its unique "one country, two systems" framework and two competing impulses: mainland China's desire to exercise control over Hong Kong, and Hong Kong citizens' desire for greater autonomy and more democratic governance. This tension has been evident in recent years, particularly as it relates to Hong Kong's electoral process.

In June 2014, Beijing moved to restrict Hong Kong's political development, rejecting calls for democratic reform and shaping the conditions of Hong Kong's current political strife. That month, the Mainland's State Council Information Office issued a strongly

*The "one country, two systems" framework is a policy measure adopted by the People's Republic of China following the establishment of Hong Kong and Macau as Special Administrative Regions. The system grants Hong Kong and Macau the right to self-govern their economy and political system to a certain extent, excluding foreign affairs and defense.

worded white paper on the implementation of the “one country, two systems” policy in Hong Kong. The white paper reiterated Beijing’s jurisdiction over Hong Kong and asserted that “loyalty” and “loving the country” are “basic political requirements for Hong Kong’s administrators,”¹ prompting concerns among Hong Kong’s prodemocracy advocates.²

Two months later, according to procedures set out in Hong Kong’s mini constitution, the Basic Law, mainland China’s central government submitted its proposal for the nomination mechanism in Hong Kong’s upcoming 2017 chief executive election. After an earlier ruling by the Mainland’s legislature that Hong Kong’s 2017 election could be decided by universal suffrage—defined as election on a “one person, one vote” basis³—many in Hong Kong were hopeful Beijing’s proposal would feature robust reforms and the introduction of universal suffrage (currently, Hong Kong’s chief executive is chosen by a committee representing only 0.03 percent of eligible voters).⁴ In a major disappointment for prodemocracy advocates, Beijing’s proposed reform stopped far short of true universal suffrage. Although the proposal would have allowed all Hong Kong permanent residents to vote, it still would have used a nomination mechanism that impeded democratic candidates from standing for election and effectively guaranteed the ultimate selection of a Beijing-approved candidate. The proposal violated the spirit of Beijing’s commitments made in the Basic Law to hold elections “in accordance with democratic procedures” and eventually institute universal suffrage.⁵

The combination of the “loyalty” requirements and electoral reform proposal was perceived by many as a blow to Hong Kong’s democratic progress,⁶ and dissatisfaction gave rise to the Occupy Central prodemocracy protests (also referred to as the “Umbrella Revolution”), which advocated for true universal suffrage according to international standards in future Hong Kong elections. The largely nonviolent protests, which lasted 79 days and concluded in December 2014, demonstrated Hong Kong citizens’ frustration with Beijing’s increasing reach into Hong Kong and served to bring more students and young people into the political process.*

When it came time to vote on Beijing’s proposal in June 2015, Hong Kong’s legislative body, the Legislative Council (LegCo), rejected it. Although the Hong Kong government supported the proposal as a baseline for future reforms, and pro-Beijing (or “pro-establishment”) legislators largely voted in favor of the proposal, prodemocracy legislators (known as “pan-democrats”) asserted it was a “sham” that would provide an opportunity for Beijing to screen out candidates it opposes, and prevented the proposal from moving forward.⁷ As a result, the 2017 chief executive election will be decided based on the preexisting election framework, and the next opportunity to implement electoral reform will be ahead of the 2022 chief executive election.†

* For more information on the 2014 prodemocracy protests, see U.S.-China Economic and Security Commission, *2014 Annual Report to Congress*, November 2014, 523–527.

† For a more in-depth examination of the electoral reform process and political development in Hong Kong in 2015, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 533–537.

Developments among Hong Kong's Political Groups in the Run-up to the 2016 LegCo Elections

Fueled in large part by the fallout from the electoral reform debate and the Occupy movement, mounting feelings of frustration and disillusionment among prodemocracy advocates—particularly among young people—appear to be driving divisions in the prodemocracy camp between the traditional, older cohort favoring gradual reform through working with Beijing and the new, younger cohort favoring more comprehensive reforms and a more confrontational approach toward Beijing. Some of the student-led groups affiliated with the 2014 Occupy movement shifted their attention away from electoral reform to the September 2016 LegCo elections. In March 2016, Joshua Wong Chi-fung—one of the student leaders of the 2014 protests—established the political party Demosistō, which would run one candidate in the LegCo elections. Rather than focusing on electoral reform, Mr. Wong said the party would turn its attention to Hong Kong's future after 2047, at which time the “one country, two systems” governance framework established during Hong Kong's handover from the UK in 1997 will expire.⁸ Mr. Wong said the party would advocate for a referendum for Hong Kong voters to decide whether to split from mainland China after 2047.⁹ Oscar Lai Man-lok, one of the party's leaders, said, “No one in the legislature right now has brought up the issue of Hong Kong's future after 2047. We're going to bring the same dogged resistance protesters showed in the Umbrella Movement into the legislature.”¹⁰

The emergence of new “localist” political parties in the run-up to the LegCo elections also demonstrates this division.* Localists are a political minority predominantly composed of students who support self-determination (and in some cases, outright independence) and the preservation of Hong Kong's culture. In February 2016, after protesting the apparent crackdown on unlicensed food vendors in Mong Kok District, over 700 localist activists clashed with police in a ten-hour standoff. Some observers called it the most violent mass demonstration since the 1967 riots triggered by pro-Beijing protesters against British colonial rule.†¹¹ The localist parties, many of which are led by former student participants in the 2014 Occupy protests, were previously viewed as fringe political actors

* Like the chief executive elections, LegCo elections are not decided by universal suffrage. The Mainland's legislature ruled that universal suffrage cannot be implemented in LegCo elections until it is implemented in the chief executive election. Standing Committee of the National People's Congress, *Decision of the Standing Committee of the National People's Congress on Issues Relating to the Methods for Selecting the Chief Executive of the Hong Kong Special Administrative Region and for Forming the Legislative Council of the Hong Kong Special Administrative Region in the Year 2012 and on Issues Relating to Universal Suffrage* (Adopted at the 31st Session of the Standing Committee of the Tenth National People's Congress on December 29, 2007).

† It is unclear what led to the unrest. According to some sources, reports that food and health inspectors were cracking down on unlicensed street food vendors led localist activists to organize protests in defense of the vendors. However, the Hong Kong government claimed inspectors were only conducting “general squad patrol” in the area when they were “surrounded, scolded, and pushed around” by over 50 people, leading the inspectors to call for police assistance. The clashes resulted in at least 100 injured—most of which were police, according to the Hong Kong government. According to the Hong Kong police commissioner, 54 were arrested in the immediate aftermath of the incident. Reports in the months following the incident indicate at least 75 people were arrested in total. Alan Wong, “China Labels Protesters ‘Radical Separatists,’ and They Agree,” *New York Times*, February 20, 2016; Legislative Council Panel on Security, *Hawker Management and Policy*, February 16, 2016; Asia Times (Hong Kong), “HK's Mong Kok Protesters: ‘This is the First Time, But Won't Be the Last,’” February 11, 2016; and BBC, “Hong Kong Clashes as Police Clear Food Stalls,” February 9, 2016.

among mainstream political circles in Hong Kong, but increasing support among Hong Kong citizens—especially young people—for greater Hong Kong autonomy from mainland China has given these groups momentum. According to a July 2016 poll conducted by the Chinese University of Hong Kong—the first ever poll measuring support for Hong Kong independence—over 17 percent of Hong Kong citizens and nearly 40 percent between the ages of 15 and 24 support full independence after 2047.¹²

Annual Vigil to Commemorate the Tiananmen Square Massacre

On June 4, Hong Kong held its annual candlelight vigil to commemorate the victims of the 1989 Tiananmen Square Massacre and express support for political change in mainland China.¹³ According to the vigil organizers, 125,000 people attended, but the turnout was 10,000 fewer than the 2015 event and the lowest attendance since 2009, which commemorated the 20th anniversary.¹⁴ Although the event has long been one of the most popular and visible demonstrations of prodemocracy sentiment in Hong Kong, some young prodemocracy activists and nearly all university student unions decided not to attend the vigil, viewing the 2016 event as less relevant to the challenges Hong Kong currently faces under Beijing's increasing encroachment.¹⁵ Instead of attending the vigil, many of the groups hosted or attended other events across Hong Kong, including seminars discussing what the Tiananmen Square Massacre means in the context of today's Hong Kong and its future.¹⁶

The 2016 LegCo Elections

The specter of Beijing's control loomed over the September 2016 LegCo elections as well. Less than two months before the election, the Hong Kong Electoral Affairs Commission*—reportedly under pressure from Beijing¹⁷—announced a new requirement for all LegCo candidates: to sign a form agreeing Hong Kong is an “inalienable” part of China that “come[s] directly under the Central People's Government.”¹⁸ Those who refused to sign the form would face potential disqualification, and candidates who signed it but did not follow through with the pledge would face potential criminal charges, according to a spokesperson for the Electoral Affairs Commission.¹⁹ In response to the announcement, most pan-democratic candidates refused to sign the pledge, viewing the requirement as political censorship and arguing it had no legal basis; some filed legal challenges to the new form.²⁰ However, civil servants tasked with reviewing the candidate application forms, which were fully supported by the Hong Kong government,²¹ decided the action of signing or not signing the form had no bearing on whether a can-

*The Electoral Affairs Commission describes itself as an “independent, impartial, and apolitical body” of the Hong Kong government, and is charged with overseeing elections. Electoral Affairs Commission, Government of the Hong Kong Special Administrative Region, *Chairman's Welcome Message*. <http://www.eac.gov.hk/en/about/chairman.htm>.

didate could run in the elections—only the measure of a candidate’s character based on previous activities would determine candidate eligibility. In the end, however, six candidates were banned, reportedly for refusing to back down from their pro-independence stance,* despite several signing the pledge.²² One of these candidates whom observers viewed as having good prospects for winning a seat, was Edward Leung Tin-kei of localist party Hong Kong Indigenous.† Just days before the deadline to confirm all candidates, in an apparent effort to adhere—or at least appear to adhere—to the Electoral Affairs Commission’s new requirements, Mr. Leung retracted his previous pro-independence statements, including on social media platforms, and signed the pledge form. Despite this, the officer overseeing his application denied his candidacy, arguing Mr. Leung’s apparent policy shift was not genuine.²³

Mainland China’s heavy-handed efforts to limit support for the prodemocracy camp backfired, however. Demonstrating the Hong Kong public’s deepening dissatisfaction with Beijing’s moves to apply pressure on Hong Kong’s political system, a record 58 percent voter turnout saw prodemocracy candidates capture 30 of 70 total seats in the LegCo elections.²⁴ Although prodemocracy candidates won a majority of the popular vote,‡ the Basic Law only allows the general public to vote for a total of 35 seats, while a small group of electors in functional constituencies decide the remaining 35 seats; these seats heavily tilt in Beijing’s favor and therefore ensure pro-establishment candidates retain a majority of seats in LegCo.§

With a net gain of three seats, the pan-democrats denied the pro-establishment camp the two-thirds majority it needed to pass major changes to the Basic Law (such as electoral reform).²⁵ Notably,

* One of these candidates was Chan Ho-tin, a former activist in the 2014 Occupy protests and convener of the Hong Kong National Party—the first political party in Hong Kong to publicly advocate for outright independence from mainland China. Beijing and the Hong Kong government have strongly opposed the party since its formation in March 2016. Although the party probably will remain on the fringes of the political landscape, its presence alone sheds light on the widening gap between some political groups in Hong Kong and shows Beijing’s fear of pro-independence parties gaining popular support. Xinhua, “China Voice: ‘Hong Kong Independence,’ A Dangerous Absurdity,” April 1, 2016; Hong Kong Special Administrative Region Information Services Department, *Independence Calls Breach Basic Law*, March 30, 2016; and KC Ng and Owen Fung, “Hong Kong National Party Is Born: Will Push for Independence, Will Not Recognize the Basic Law,” *South China Morning Post* (Hong Kong), March 29, 2016.

† Mr. Leung surprised observers with strong results, despite a lack of political experience, in the February 2016 New Territories East by-election to fill a vacant seat in LegCo until the September elections. He participated along with his political group, Hong Kong Indigenous, in the violent Mong Kok demonstrations weeks before the by-election. Gary Cheung, “Despite Facing a Rioting Charge, Localist Edward Leung Garnered 16 Per Cent of Legco By-Election Votes. Who Voted for Him . . . and Why?” *South China Morning Post* (Hong Kong), February 29, 2016.

‡ According to the *South China Morning Post*, for the 35 seats decided by popular vote, pro-establishment candidates won 871,864 votes (40.3 percent), pan-democrats captured 586,595 votes (27 percent), “localist/radical” candidates received 601,851 votes (27.6 percent), and moderates won 5 percent of the vote. In total, prodemocracy candidates received 59.7 percent of the vote compared to pro-Beijing candidates’ 40.3 percent. *South China Morning Post* (Hong Kong), “2016 Legislative Council Election Counting Room.” <http://multimedia.scmp.com/counting-room/>; Suzanne Pepper, “The Voters Have Spoken . . . But is Anyone Listening?” *HK Focus* (Blog), September 20, 2016.

§ Electors who choose the 35 functional constituency seats are part of 28 different groups that include businesspeople, professionals, and corporations. Of the 239,724 electors registered in 2016, 167,257 votes were cast, electing 24 of the pro-establishment camp’s 40 seats. *South China Morning Post* (Hong Kong), “2016 Legislative Council Election Counting Room.” <http://multimedia.scmp.com/counting-room/>; Suzanne Pepper, “The September Election: Early Polling,” *HK Focus* (Blog), August 18, 2016; Voter Registration of the Hong Kong Special Autonomous Region Government, *Distribution of Registered Electors by Functional Constituencies in 2016*, July 16, 2016; and Tanna Chong, “Legco Election 2016: How a Handful of Voters Select 30 Hong Kong Lawmakers,” *South China Morning Post* (Hong Kong), February 6, 2016.

eight of the prodemocracy candidates who won seats—five of whom are part of the post-Occupy generation of prodemocracy political parties—advocate for self-determination; several of these winning candidates are young localists.²⁶ These newly elected lawmakers unseated some veteran prodemocracy legislators, reflecting the recent shift in Hong Kong’s political landscape.²⁷ Demosistō’s Nathan Law Kwun-chung, one of the student leaders of the 2014 prodemocracy protests, at 23 years old became the youngest legislator ever elected to LegCo, overcoming numerous roadblocks along the way.* Mr. Law and several other new lawmakers have pledged to continue filibuster tactics used in the previous legislative session (2012–2016) to oppose the Hong Kong administration’s policies, suggesting LegCo will remain deadlocked as its membership becomes further polarized.²⁸

Beijing heavily restricted all mainland media coverage of the election and censored discussion of the election on the Internet and social media in mainland China.²⁹ A spokesperson for the State Council’s Hong Kong and Macau Affairs Office in Beijing issued a statement expressing its “resolute opposition to any form of Hong Kong independence activities inside or outside of [LegCo], and support for the Hong Kong Special Administrative Region government to punish [such activities] according to law.”³⁰

Disappearance of Hong Kong Booksellers

Among the many incidents over the last several years that have caused a steady erosion of the freedoms guaranteed to Hong Kong citizens under the Basic Law, perhaps none has had as significant a chilling effect as the mainland authorities’ apparent abduction and detention of five Hong Kong sellers of political gossip books banned in mainland China. The booksellers were all tied to Mighty Current Media, Hong Kong’s largest political gossip book publisher (which reportedly produced around one-third of such books over the last five years).³¹ It is unclear what exactly instigated Beijing’s crackdown on the booksellers, but a source at Mighty Current suggested the publishing company was preparing to release a particularly salacious book on Chinese President and General Secretary of the Chinese Communist Party (CCP) Xi Jinping’s love life.³² The incident involved not only Hong Kong residents, but also a British citizen and a Mainland-born bookseller with a Swedish passport. The disappearance of the booksellers, whose whereabouts were unknown for six months, raised concerns about Hong Kong’s autonomy and rule of law among Hong Kong citizens, including those not previously worried about such issues, and demonstrated the deterioration of the “one country, two systems” framework.³³

*These roadblocks included delays in government approval for campaign mailings and for registering Demosistō as a company for fundraising purposes. Cannix Yau, “Six Months and Counting: Demosisto Party Still Waiting for a Reply on Its Registration,” *South China Morning Post* (Hong Kong), September 11, 2016; Chester Yung, “Hong Kong Elections: New Parties Pick Up Seats,” *Wall Street Journal*, September 5, 2016; and Tony Cheung, “Undue Caution? Joshua Wong Blasts Hong Kong Officials over Hold-Ups in Demosisto Party Registration and Mailings,” *South China Morning Post* (Hong Kong), August 4, 2016.

Hong Kong's Political Gossip Book Industry

The market for banned books in mainland China was a key driver in the emergence of Hong Kong's political gossip book industry. Customers included Chinese citizens interested in learning about the inner workings of Chinese politics, and mainland officials using the publications to either leak salacious details about other officials or seek out these details in existing publications for political gain.³⁴ Observers note that in recent years, following the Bo Xilai scandal,* the industry has expanded significantly and become highly profitable.³⁵ In a January 2016 interview, Bei Ling, a U.S.-based exiled Chinese journalist and close friend of one of the detained Hong Kong booksellers, estimated that about half of all books published in Hong Kong are on topics banned in the Mainland and reach nearly one million people per month (but these numbers appear reduced in light of the booksellers incident, as discussed below). According to Mr. Bei, "The severe restrictions on information in China, and its huge number of readers, makes Hong Kong the perfect venue for vendors of banned political books."³⁶

Within a nine-day span in October 2015, three Hong Kong citizens tied to Mighty Current and one of its Hong Kong bookstores, Causeway Bay Books, went missing from Hong Kong and mainland China. These included Mighty Current shareholder and general manager Lui Por (also spelled Lu Bo), Mighty Current assistant general manager Cheung Chi-ping (also spelled Zhang Zhiping), and Causeway Bay Books manager Lam Wing-kee. Mighty Current shareholder and Swedish national Gui Minhai, went missing from his vacation home in Thailand that same month.[†]³⁷ In December 2015, a fifth person, Mighty Current shareholder and dual British and Hong Kong citizen Lee Bo disappeared after crossing into mainland China. It is unclear how Mr. Lee crossed the border into the Mainland, and many suspect Chinese agents were involved in abducting him.³⁸ The booksellers remained missing for months until mainland authorities finally confirmed in January and February 2016 that they were in Chinese custody in the Mainland.³⁹

The behavior and activities of the booksellers during the ordeal suggest they were intimidated and otherwise treated unlawfully. Following a trend throughout President Xi's anticorruption campaign in which individuals detained in the Mainland have issued confessions on state-run television, all five of the detained booksellers appeared on Chinese television to confess to their alleged crimes.⁴⁰ Notably, Mr. Lee said he decided to relinquish his British

* Bo Xilai was a member of the CCP Politburo and the party secretary of Chongqing Municipality from 2007 to 2012. In April 2012, the CCP removed Mr. Bo from his party positions, and the following September he was found guilty of corruption, bribery, and abuse of power and sentenced to life in prison. BBC, "Bo Xilai Scandal: Timeline," November 11, 2013.

† In May 2016, Mr. Gui's daughter testified before the U.S. Congressional-Executive Commission on China regarding her father's case. She said her father was abducted by "Chinese state agents" in Thailand, and he has not had any legal representation or access to consular visits with his home country Sweden. Congressional-Executive Commission on China, *Hearing on The Long Arm of China: Global Efforts to Silence Critics from Tiananmen to Today*, written testimony of Angela Gui, May 24, 2016.

passport as a result of the case. He said, “Many have sensationalized my British citizenship and have complicated the situation, so I have decided to give up my British citizenship.”⁴¹ It is unclear if the detained individuals had access to a lawyer or were forced to confess.⁴²

After months in detention, Beijing finally allowed three of the booksellers—Mr. Cheung, Mr. Lui, and Mr. Lee—to return to Hong Kong in March 2016. Upon arrival, the booksellers told the Hong Kong authorities to cancel their missing persons investigations, and then returned almost immediately to mainland China.⁴³ Mr. Lee informed Hong Kong police he went to mainland China “by his own means voluntarily,” and told the media he would never publish books again.⁴⁴ In June, the Chinese authorities allowed Mr. Lam to return to Hong Kong, reportedly to retrieve and bring back a hard drive containing records of the bookstore’s customers.⁴⁵ Instead, he stayed in Hong Kong and held a press conference with then Democracy Party lawmaker Albert Ho Chun-yan, describing in detail his detention after crossing into mainland China to see his girlfriend. Mr. Lam said he was sent to a detention facility in Ningbo and forced to sign away his rights to a lawyer and not contact any family members. During his five months in Chinese custody, he was under constant monitoring and was forced to read from a script in a filmed statement he made confessing to operating an illegal business.⁴⁶ In the days following the press conference, Mr. Lam led thousands of people in Hong Kong protesting the booksellers’ detention.* Perhaps indicative of mainland efforts to discredit Mr. Lam’s account, shortly thereafter a Hong Kong news outlet published interviews with several individuals—including some of the other detained booksellers and Mr. Lam’s girlfriend—challenging Mr. Lam’s version of events.⁴⁷ As of the publication of this Report, Mr. Gui is reportedly the only bookseller still in Chinese custody.⁴⁸

As the situation unfolded, the Hong Kong government expressed concern, while emphasizing the importance of adhering to the “one country, two systems” framework and the Basic Law.⁴⁹ Chief Executive Leung in January 2016 said the Hong Kong government was “highly concerned” about the situation, and that if mainland authorities conducted law enforcement activities in Hong Kong it would be “unacceptable and unconstitutional.”⁵⁰ The Hong Kong government stated that police have yet to find any evidence to indicate mainland agents conducted law enforcement across the border in Hong Kong.†⁵¹

*Notably, Mr. Lam was scheduled to lead the annual July 1 protest against mainland China marking the day the UK returned Hong Kong to the PRC, but cancelled after feeling “gravely threatened” by apparent Chinese security forces closely tracking his movements. Rishi Iyengar, “Freed Hong Kong Bookseller, Due to Lead Massive Protest, Pulls out Citing Threats,” *Time*, July 1, 2016; Luisetta Mudie, “Returned Hong Kong Bookseller Leads Thousands on Protest March,” Radio Free Asia, June 18, 2016.

†Following Mr. Lam’s revelations to the media in June 2016, Chief Executive Leung wrote a letter to Beijing expressing Hong Kong’s concern about the case and indicated he would seek to improve the cross-border notification mechanism system between the Hong Kong and Mainland authorities. The mainland government responded that it would work with Hong Kong authorities to improve the mechanism in place. The two sides have held several meetings to date. Hong Kong Special Autonomous Region Government, *Hong Kong and Mainland Hold Second Meeting on Notification Mechanism*, July 28, 2016; Kris Cheng, “Beijing Agrees to Talks on HK-China Communication Mechanism Following Bookseller Incident,” *Hong Kong Free Press*, June 27, 2016; Reuters, “Hong Kong Presses Beijing on Case of Missing Booksellers,” June 21, 2016;

Many Hong Kong and international observers have voiced concerns that mainland China is depriving Hong Kong of its rights granted under the Basic Law, and that the incident could impact Hong Kong's status as a global financial center.⁵² In February 2016, a U.S. Department of State spokesperson said, "These cases, including two involving individuals holding European passports, raise serious questions about China's commitment to Hong Kong's autonomy under the "one country, two systems" framework as well as its respect for the protection of universal human rights and fundamental freedoms."⁵³ The same month in a biannual report on developments in Hong Kong, then British Foreign Secretary Philip Hammond said the "involuntary removal" of Mr. Lee to the Mainland "constitutes a serious breach of the Sino-British Joint Declaration on Hong Kong and undermines the 'One Country, Two Systems' principle, which assures Hong Kong residents of the protection of the Hong Kong legal system."⁵⁴ An April 2016 European Commission report to the European Parliament and Council stated the following:

*The [EU] considers the case of the five book publishers to be the most serious challenge to Hong Kong's Basic Law and the "one country, two systems" principle since Hong Kong's handover to the [People's Republic of China (PRC)] in 1997. The case raises serious concerns about the respect for human rights and fundamental freedoms and about the application of PRC criminal law to acts that are not punishable under Hong Kong law. The case has potentially lasting implications for Hong Kong's rule of law and could impact on Hong Kong's standing as an international business centre.*⁵⁵

While the long-term effects of the Hong Kong booksellers incident are unclear, immediate impacts were felt throughout the book publishing industry and beyond. In April 2016, Hong Kong lawyer and blogger Jason Ng released his new English-language account of the 2014 Occupy movement, after facing a more than three-month delay because local printing companies refused to take on the work. Mr. Ng's British publisher, who has run a Hong Kong-based publishing company since 2003, said this was the first time he had been declined by a local printer.⁵⁶ In addition, Andrei Chang, founder of the influential defense magazine *Kanwa Asian Defense* (which carries analysis of People's Liberation Army [PLA] developments), decided to move from Hong Kong to Tokyo out of fear for his safety following Chinese Foreign Minister Wang Yi's comments describing one of the detained booksellers and British passport holder Lee Bo as "first and foremost a Chinese citizen."⁵⁷ Mr. Chang had held both Hong Kong and Canadian passports until he decided to cancel his Hong Kong passport shortly after Minister Wang's remarks.⁵⁸

Perhaps most troubling, several Hong Kong bookstores have reportedly removed politically sensitive titles and stopped selling banned books altogether.⁵⁹ Some bookstores known for carrying

and Jeffie Lam, et al., "Delegations, Notifications, and a Formal Letter: CY Leung's Three-Pronged Strategy for Settling Booksellers Row," *South China Morning Post* (Hong Kong), June 20, 2016.

books banned in the Mainland have closed entirely, notably in the Hong Kong airport, where some have been replaced by Chinese state-owned Chung Hwa Book Company.* The scope of the impact of the booksellers incident is not yet clear,† but the Chinese government's willingness to strike fear in an industry that represents Hong Kong's role as a bastion for free speech and political openness does not bode well.

Joshua Wong Denied Entry to Thailand and Returned to Hong Kong

In October 2016, following the LegCo elections, Joshua Wong Chi-fung was invited to speak at two universities to share his experiences about the 2014 Occupy protests and youth participation. When he arrived at Bangkok's main airport, Mr. Wong said more than 20 Thai police and immigration officers were waiting for his arrival. According to Mr. Wong, they confiscated his passport and detained him for almost 12 hours without access to a lawyer, providing little explanation except that he was on a "blacklist" and would never be allowed entry into Thailand.⁶⁰ The Thai authorities eventually placed him on a flight back to Hong Kong and upon his arrival he said that he felt lucky to have not shared the same fate as Gui Minhai, the Hong Kong bookseller who was apparently abducted from Thailand and sent back to mainland China.⁶¹ A Thai student activist who was to meet Mr. Wong at the airport said that Thai authorities claimed Beijing wrote a letter requesting Mr. Wong be denied entry to Thailand, but Bangkok denied receiving such a request.⁶² In a similar incident in May 2015, Malaysia blocked Mr. Wong's entry into the country, where he was due to participate in Malaysian youth activist forums, citing the visit could "jeopardize [Malaysia's] ties with China."⁶³

Declining Freedom of Expression in Hong Kong

Press Freedoms Continue to Be at Risk

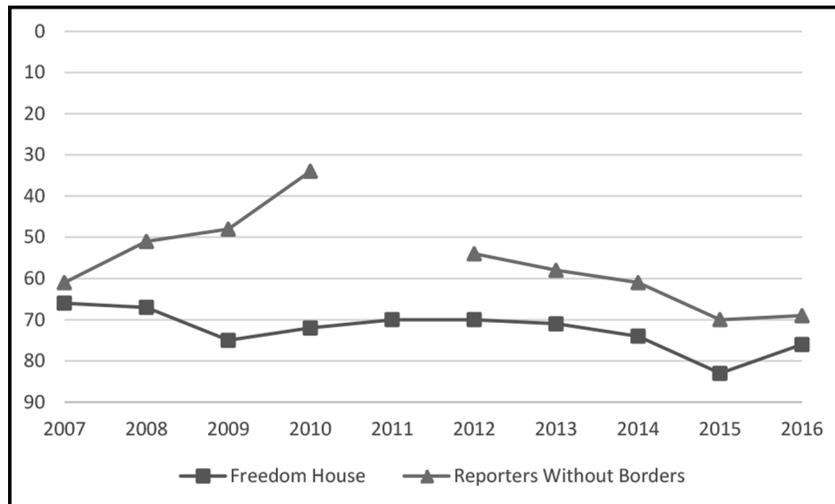
In addition to the impact of the booksellers case on freedom of expression in Hong Kong, according to watchdog organizations several other developments demonstrate continued strains on press freedom, even though the Basic Law guarantees freedom of the press in Hong Kong (see Figure 1). International nonprofit Reporters Without Borders ranked Hong Kong 69th among 180 countries and territories evaluated in its 2016 global press freedom index,

* According to the Hong Kong Airport Authority, it decided to consolidate the number of bookstores from 16 to 10 based on "a regular customer survey and an assessment on passenger needs." Elaine Yu, "Hong Kong Airport Shuttles Bookstores Amid Fears of Eroding Press Freedoms," CNN, April 12, 2016.

† Some in Hong Kong's book publishing business have contested the impact of the incident on the industry, citing the continued publishing of some political gossip books and the active underground market. Oliver Chou, "Banned Books: Hong Kong Publication Industry Collapsing," Sings Chief Editor of New York-Based Publishing House," *South China Morning Post* (Hong Kong), March 11, 2016.

moving up one place compared to 2015.* Despite the slightly improved position on the index, Hong Kong's overall score declined, mainly due to the encroaching influence of the Chinese government in Hong Kong newspapers' editorial positions and Chinese e-commerce group Alibaba's purchase of the *South China Morning Post* (discussed later in this section).⁶⁴ According to Freedom House, an independent international organization, Hong Kong's position also improved in the organization's global press freedom ranking—moving up seven spots to 76th among 199 countries and territories evaluated—primarily due to easing tensions following the 2014 pro-democracy protests and the establishment of several new online independent Hong Kong media organizations.[†] However, Freedom House also dedicated a special section of its global press freedom report to Hong Kong developments, asserting the further deterioration of Hong Kong's press freedom due to Alibaba's acquisition of the *South China Morning Post* and the booksellers incident.⁶⁵ Notably, both rankings only account for developments occurring in 2015, and thus do not include full coverage of the Hong Kong booksellers incident.

Figure 1: Hong Kong's Global Press Freedom Ranking, 2007–2016



Note: Reporters Without Borders did not publish a report in 2011 and instead published a 2012 report reflecting events between December 1, 2010, and November 30, 2011.

Source: Reporters Without Borders, "Hong Kong," April 2016. <https://rsf.org/en/hong-kong>; Freedom House, "Freedom of the Press 2016," April 2016. <https://freedomhouse.org/report/freedom-press/freedom-press-2016>.

Moreover, Hong Kong citizens are increasingly disappointed with the level of press freedom, according to recent polls. An April 2016 survey conducted by the University of Hong Kong's Public Opinion Programme found that only 46 percent of people are satisfied with

* In this ranking, 180 represents the country or territory with the lowest press freedom. Reporters Without Borders, "Hong Kong," April 2016.

† In this ranking 199 represents the country or territory with the lowest press freedom. Freedom House, "Freedom of the Press," April 2016, 23.

press freedom, while 33 percent are dissatisfied—the highest level of dissatisfaction for press freedom since the handover of Hong Kong to the PRC in 1997.⁶⁶

Violence against Journalists

Violence against journalists in Hong Kong persisted over the past year. The Hong Kong Journalists Association in its 2016 Annual Report reported that at least seven journalists were attacked from July 2015 to June 2016.⁶⁷ Although this is a slight improvement over recent years, it still far exceeded what the Association refers to as “normal” years, in which two to three incidents take place.⁶⁸ Six of the seven attacks occurred during the February 2016 Mong Kok incident, and were perpetrated by both demonstrators and law enforcement.⁶⁹ One reporter for Hong Kong Chinese-language newspaper *Ming Pao* was assaulted by police even after complying with orders to show his press credentials; he required treatment at a local hospital after sustaining head and hand injuries.⁷⁰

Politically Motivated Censorship

Mainland China is able to impart influence on media companies in Hong Kong through Chinese ownership and other means of applying pressure. According to the Hong Kong Journalists Association, the Chinese government or Mainland-based corporations have either direct control or stakes in 8 of 26 mainstream media organizations,* and the owners or news department leadership in 80 percent of these organizations have received appointments or awards from pro-Beijing bodies or individuals.† In recent years, self-censorship has increased as a result of pressure applied by Chinese and foreign companies to induce Hong Kong media to align with the CCP in their portrayal of news, resulting in journalists removing articles and editorials critical of the party. In other cases, editors and staff have been removed from their posts. Over the last year, examples of politically motivated censorship include the following:

- In April 2016, Chong Tien-siong—the principal editor of *Ming Pao* and a prominent businessman in the Mainland—fired a popular senior editor at the paper, Keung Kwok-yuen, shortly after he published a front page story on offshore holdings connected to Hong Kong’s elite that were disclosed in the International Consortium of Investigative Journalists’ “Panama Papers” leaks (for more information on the economic implications of the Panama Papers for Hong Kong, see the textbox later in this section on “Hong Kong and the ‘Panama Papers’ Case”).⁷¹ Mr. Keung’s termination was widely viewed among *Ming Pao* staff and other media as related to his work on politically sensitive reporting. Since assuming his position in May 2014, Mr. Chong has overseen violations in editorial practices and

*These news outlets include: *Ta Kung Pao*, *Wen Wei Po*, *Hong Kong Commercial Daily*, *China Daily* (Hong Kong edition), *Sing Pao Daily News*, Phoenix Satellite Television, TVB, and the *South China Morning Post*. Hong Kong Journalists Association, “One Country, Two Nightmares: Hong Kong Media Caught in Ideological Battleground,” July 2016, 5.

†For example, in July 2016, owner of Phoenix Satellite Television and media tycoon Liu Changle won an award for his distinguished service at the Hong Kong government’s annual awards ceremony. Hong Kong Journalists Association, “One Country, Two Nightmares: Hong Kong Media Caught in Ideological Battleground,” July 2016, 5; Ng Kang-chung, “Hong Kong Award Winners Announced: Carrie Lam Receives Top Civic Medal,” *South China Morning Post* (Hong Kong), July 1, 2016.

quashed articles that were politically sensitive.* In response to the firing of Mr. Keung, some *Ming Pao* columnists refused for days to write their regular columns,⁷² and around 400 journalists, activists, and politicians led a protest outside the *Ming Pao* offices. In addition, the Hong Kong Journalists Association issued a joint letter from eight journalist groups calling for Mr. Keung's reinstatement.⁷³

- In December 2015, China's largest e-commerce firm, Alibaba, announced its \$266 million purchase of the *South China Morning Post*, Hong Kong's most popular English-language newspaper.⁷⁴ Alibaba said the main driver of the deal was to help improve China's image abroad and offer an alternative to what it perceives as bias in Western media.⁷⁵ However, Jack Ma, the company's chief executive officer, said the newspaper would maintain editorial independence and not censor content.⁷⁶ According to David Bandurski, editor of the China Media Project at the University of Hong Kong, such claims would probably be difficult to maintain.⁷⁷ Mr. Bandurski said, "[I think] that a lot of [Hong Kong] newspapers in Chinese, and also the [*South China Morning Post*] even before this purchase, have carefully considered what to report in light of their business interests or [political] pressure."⁷⁸ Others note that although a foreign businessman supportive of China owned the newspaper previously, Alibaba's purchase would more firmly place the paper under Beijing's influence due to its close connection to the Chinese government.⁷⁹

Challenges to Academic Freedom

Universities in Hong Kong have historically enjoyed a high degree of autonomy and academic freedom, as protected under the Basic Law. Nonetheless, in recent years such freedoms have been challenged, as Beijing and the Hong Kong government remain wary of prodemocracy activism—and especially the spread of pro-independence thought more recently—among university students and academics.

In 2015, the governing council at the University of Hong Kong (HKU), Hong Kong's premier academic institution, made a controversial decision to delay and ultimately reject the appointment of a prodemocracy academic for a leadership position at the university. The incident caused many in the university community and at other academic institutions to assert that Beijing and the Hong Kong government blocked the appointment.†

Further controversy at HKU continued into 2016. In January 2016, Arthur Li Kwok-cheung, a member of the HKU governing council‡ that helped block the aforementioned academic's appoint-

* For examples of Mr. Chong's decisions as editor of *Ming Pao*, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 540–541.

† For more information about this case, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 542–543.

‡ The HKU governing council consists of 24 members, including current Chairman Arthur Li Kwok-cheung; six members appointed by HKU Chairman (and Hong Kong Chief Executive) CY Leung; six members appointed by the Council; two members elected by the Court; the university president (and vice chancellor); the university treasurer; four faculty members; one university employee (non-faculty); and two students. University of Hong Kong, "Governance Structure—The Council." http://www.hku.hk/about/governance/governance_structure/the-court/council_membership.html.

ment, was appointed as chairman of the governing council. Mr. Li, who is pro-Beijing, was appointed to the chairmanship by his close friend Chief Executive Leung, and he concurrently serves as a member of the Chinese People's Political Consultative Committee, the Chinese government's chief advisory body. In response to the appointment, 20 student and activist organizations led a march to protest Chief Executive Leung's decision (organizers said over 3,000 people participated, while police said protesters only numbered 830).⁸⁰ Student groups also led a one-week boycott of classes at the start of the semester, voicing their concerns about the university losing its democratic freedoms and facing increasing pressure from Beijing. Professor Timothy O'Leary, head of HKU's School of Humanities and co-organizer of HKU Vigilance, a group of professors examining academic freedom, said, "We are [protesting] to make sure the universities can go on being places in which people are free to think and ask questions . . . that some people do not want them to think about and to discuss."⁸¹ University students are pushing for reforms in the school's governance structure, but the governing council and students have been unable to agree on terms to set up a meeting.⁸² In April 2016, the council formed an independent three-person panel* to review the school's governance mechanisms and discuss potential reforms; the panel's findings are expected by the end of 2016.⁸³

Responding to the rising popularity of pro-independence views among students in Hong Kong,⁸⁴ Beijing and the Hong Kong government have stepped up efforts to restrict discussion of independence and related topics in schools. In August 2016, a mainland official stated that discussions of independence should be banned in primary and secondary schools, as such discussions would "poison" students' minds.⁸⁵ The Hong Kong Education Bureau announced that teachers could lose their jobs if they promote the idea of Hong Kong independence, sparking a debate across Hong Kong civil society.⁸⁶ Hong Kong Secretary of Education Eddie Ng Hak-kim, reportedly after returning from meetings with officials in Beijing, elaborated that "students [could] discuss anything if they are under the guidance of teachers," but the topic "should be discussed from the position of the Basic Law."⁸⁷ Chief Executive Leung reiterated the need to remove discussion of independence from schools, arguing, "it's not an issue of freedom of speech, but being able to tell right from wrong."⁸⁸ Some teachers and prodemocracy advocates have said they fear the new policy would lead to self-censorship in schools and further constraints on academic freedom.⁸⁹ One teacher said, "I am very worried that this will give rise to a chilling effect, and that this warning is very close to [ideological] direction . . . and that it will be on a list of banned topics. Nobody will dare to touch it at all."⁹⁰ The Hong Kong government has yet to clarify the legal basis for this new policy amid calls from teachers' unions and legal scholars and has remained vague as to what actions would constitute a breach of the policy.⁹¹

*Panel members include Chancellor of the University of York Sir Malcom John Grant, who will serve as the panel's chairman, Professor William C. Kirby of Harvard University, and Peter Van Tu Ngyun, a former Hong Kong high court judge. University of Hong Kong, "HKU Council Establishes the Review Panel on University Governance and Appoints Members to the Panel," April 26, 2016.

Chinese Censorship of Prize-Winning Hong Kong Film *Ten Years*

During the past year, some Hong Kong film critics celebrated the release of the low-budget, independent Hong Kong movie *Ten Years* as one of the top Hong Kong films in decades. The movie consists of short stories set ten years from the present day, portraying a dystopian future where Hong Kong has lost much of its culture and freedoms to mainland China. Over the film's short time in theatres, it led box office sales, beating out *Star Wars* in one theatre's box office receipts where both films appeared.⁹² The *Global Times*, a nationalist state-run Chinese newspaper, called the movie "absurd," "pessimistic," and a "thought virus."⁹³ Less than two months after gaining a wide release in Hong Kong, the film was abruptly removed from theatres, leading many to question Beijing's involvement in quashing the movie. Shu Kei, a film critic and professor at the Hong Kong Academy for Performing Arts, said, "I have never heard of anywhere else that a film that sells full houses at every single screening is pulled out from the theatres, but no exhibitor will admit censorship or direct pressure from China."⁹⁴

Moreover, after *Ten Years* received a nomination for best film—which it would later win—at the Hong Kong Film Awards, the city's version of the Oscars, Beijing enacted a ban on the show's broadcast in mainland China for the first time and censored all mentions of the movie in media reporting about the ceremony.⁹⁵ Chinese censorship of the awards show broadcast follows a tightening on media controls in mainland China and a crackdown on any form of independent thoughts or ideas promoting prodemocracy stances.

Hong Kong's Economy and its Economic Ties with Mainland China

Hong Kong remains an important global financial hub. According to a UN report, Hong Kong is the world's second largest recipient of foreign direct investment (FDI) inflows (\$175 billion) after the United States, and third largest in terms of FDI outflows in Asia (\$55 billion) after Japan (\$129 billion) and mainland China (\$128 billion).⁹⁶ In 2015, Hong Kong's gross domestic product (GDP) grew by 2.4 percent, down from 2.7 percent growth the previous year, and is expected to grow by 1–2 percent in 2016.⁹⁷ This downward trend is mostly a result of declines in incoming visitors and retail sales, especially luxury goods, likely related to the Mainland's recent economic slowdown and Beijing's anti-corruption drive.* From January to June 2016, Hong Kong experienced a 7.4 percent year-on-year decline in tourism after a 3.9 percent year-on-year increase in 2015; mainland visitors, who made up over 77 percent of total visitors, declined by 10.6 percent over the same period in 2016

* For example, Hong Kong's Chow Tai Fook, the largest jeweler in the world, has seen sales drop 22 percent from April through June on an annualized basis. Other luxury retailers have reportedly been closing stores over the past year. Ben Bland, "Hong Kong: One Country, Two Economies," *Financial Times*, July 19, 2016.

after increasing 5.6 percent year-on-year in 2015.⁹⁸ Merchandise exports—the largest being jewelry and precious or semi-precious materials⁹⁹—faced sluggish demand, dropping 3.9 percent year-on-year from January to June 2016.¹⁰⁰ Because of Hong Kong's close ties with the Mainland, China's recent economic weakness has exacerbated Hong Kong's economic downturn.¹⁰¹

Beijing continues to rely on Hong Kong as one of its most important economic partners.* Hong Kong is China's top entrepôt, where 61 percent of re-exports † (i.e., goods made in China, shipped to Hong Kong, and then re-exported to the Mainland and other foreign markets) were from mainland China; 54 percent of re-exports were shipped to mainland China in 2015, according to the Hong Kong Trade Development Council.¹⁰² Hong Kong is China's largest source of FDI, totaling 51 percent of all foreign investment in China by the end of 2015.¹⁰³ Likewise, mainland China is a leading investor in Hong Kong, with Chinese investment reaching approximately \$448 billion (30.1 percent of inbound Hong Kong investment) by the end of 2014.¹⁰⁴ These investment data are distorted, however, as “roundtripping” is a common practice. Just as trade between Beijing and Hong Kong involves a significant number of re-exports, analysts estimate 40 percent of all FDI flows into Hong Kong are then reinvested in China.¹⁰⁵

Hong Kong and the “Panama Papers” Case

The so-called Panama Papers—11.5 million financial documents of one of the world's leading firms incorporating offshore companies, Panamanian law firm Mossack Fonseca, leaked to the German newspaper *Süddeutsche Zeitung* and then posted online by whistleblower nonprofit International Consortium of Investigative Journalists (ICIJ)—exposed Hong Kong's central role as one of the world's largest hubs for intermediary companies (including banks, law firms, accountants, and others) to operate. From the documents, the ICIJ found that relatives of three CCP Politburo Standing Committee officials, including relatives of General Secretary Xi, have controlled offshore firms, exposing how Chinese elites move wealth out of mainland China.¹⁰⁶ According to the Panama Papers, of the more than 14,000 intermediaries that served clients of the law firm, over 2,200 operated in Hong Kong. Over the last 40 years, Mossack Fonseca incorporated 37,675 companies in Hong Kong—more than in any other country or territory.¹⁰⁷ Hong Kong's status as an attractive territory for such activity is largely a product of its independent legal system, simple tax regime, and free trade and capital flow. Among other things, the revelations in the Panama Papers illustrate the recent pattern of Chinese capital flight through Hong Kong into

*Although Hong Kong is part of China, it has a separate legal structure and is treated as “overseas” for the purposes of most regulations governing the ability of mainland Chinese to trade, travel, transfer funds, and conduct other transactions.

† Re-exports are exports of imported goods, typically in the same state as previously imported. UN International Trade Statistics, “Distinction between Exports and Re-Exports/Imports and Re-Imports.” <http://unstats.un.org/unsd/tradekb/Knowledgebase/Reexports-and-Reimports>.

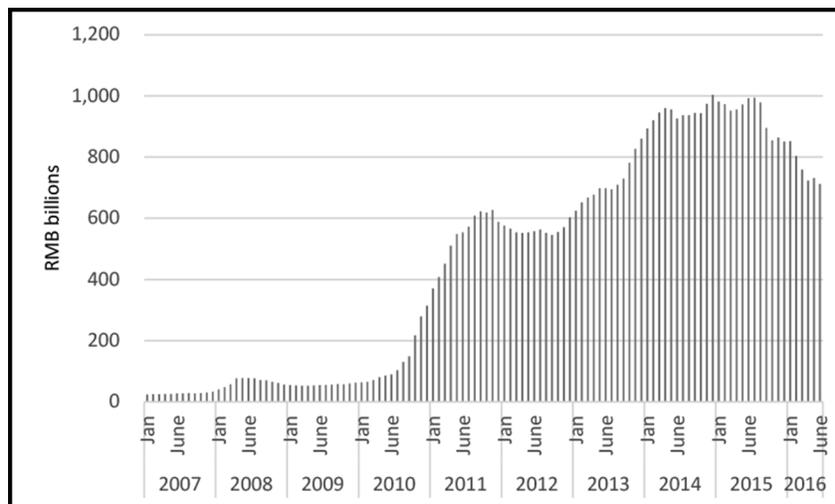
Hong Kong and the “Panama Papers” Case—Continued

foreign tax havens.¹⁰⁸ Although the impact of the disclosures on Hong Kong’s role as a hub for intermediary companies is unclear, it could lead the families of Chinese officials and other wealthy individuals to keep their assets in offshore entities filed outside of Hong Kong to maintain greater protection from whistleblowers.¹⁰⁹

Hong Kong’s Role in Mainland China’s Financial Reforms

Due to Hong Kong’s status as a global financial hub, China uses Hong Kong as its main platform to drive internationalization of the renminbi (RMB). China’s 13th Five-Year Plan (2016–2020), announced in March 2016, emphasizes capital account liberalization and RMB internationalization (for more information on China’s most recent five-year plan, see Chapter 1, Section 3, “China’s 13th Five Year Plan”).¹¹⁰ Beijing seeks to expand the use of the RMB around the world by allowing the currency to be traded in the global marketplace. In November 2015, the International Monetary Fund’s decision to include the RMB in its basket of Special Drawing Rights (effective October 1, 2016) was viewed as an opportunity to increase international demand for the RMB (see Chapter 1, Section 1, “Year in Review: Economics and Trade,” for more on this development).¹¹¹ One of the key challenges facing Beijing is continuing to boost RMB deposits in Hong Kong while more investors convert their money into Hong Kong dollars (HKD) to move capital out of mainland China.¹¹² As of June 2016, RMB customer deposits in Hong Kong have fallen over 28 percent year-on-year compared to 2015, according to Hong Kong Monetary Authority data (see Figure 2).¹¹³

Figure 2: RMB Deposits in Hong Kong, 2007–June 2016

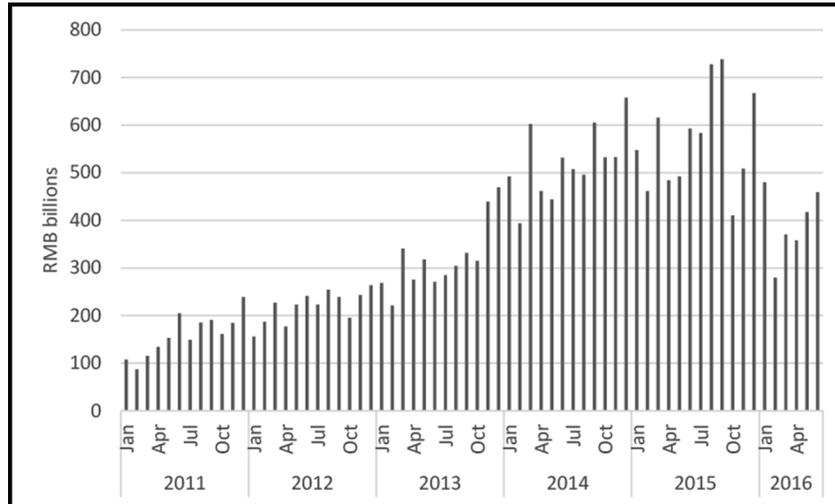


Source: Hong Kong Monetary Authority.

RMB Trade Settlement

Hong Kong banking institutions serve local and foreign banks and companies to conduct RMB trade settlement, payments, financing, and investments—another important component of Beijing’s strategy to internationalize the RMB. Hong Kong continues to be the largest hub for offshore RMB trade settlement, capturing over 90 percent of the world’s total as of the end of 2014.¹¹⁴ In 2015, RMB trade settlement grew over 9 percent year-on-year to RMB 6.8 trillion (\$1.03 trillion).¹¹⁵ However, in the first six months of 2016, trade settlement declined to RMB 2.4 trillion (\$355.5 billion), down 26 percent year-on-year (see Figure 3).¹¹⁶

Figure 3: Monthly Cross-Border RMB Trade Settlement through Hong Kong Banks, 2011–June 2016



Source: Hong Kong Monetary Authority.

Shanghai-Hong Kong Stock Connect

Viewed by many observers as one of the most important developments in recent years to advance Beijing’s efforts to internationalize the RMB, the Shanghai-Hong Kong Stock Connect launched in November 2014, linking the Shanghai and Hong Kong stock exchanges.* Mainland China intended to establish the stock connect as a gateway to bring foreign investment into Chinese shares, but the program has disappointed since its launch. After an initial period of investor excitement, trading volume has declined considerably and, since late 2015, inflows to Hong Kong via the stock connect have been increasing relative to inflows to Shanghai. In January 2016, Chinese investments in Hong Kong stocks outpaced flows

*For more information about the establishment of the Shanghai-Hong Kong Stock Connect and developments over its first year of operations, see U.S.-China Economic and Security Review Commission, *2015 Annual Report to Congress*, November 2015, 548–552.

in the opposite direction for the first time, likely due to Chinese investors seeking to escape market volatility in mainland China.¹¹⁷

Since its launch, the platform has encountered a number of obstacles that continue to hinder its effectiveness in bringing greater foreign investment inflows into Shanghai's market. One of the main challenges is that the two sides have important regulatory differences. Beijing maintains a daily quota on total investments into Hong Kong—with northbound trading capped at around \$1.9 billion and southbound trading capped at \$1.6 billion¹¹⁸—and restricts the ability of Chinese citizens to participate based on minimum account balances. In addition, China restricts short selling and suspends companies that rise or fall by 10 percent for the day, while Hong Kong does not have such limits.¹¹⁹

Financial analysts in Hong Kong believe the Shanghai-Hong Kong Stock Connect may be boosted by the opening of a Shenzhen-Hong Kong Stock Connect, which has faced a months-long delay due to Chinese market volatility* and regulatory obstacles on the Chinese side.¹²⁰ The Shenzhen-Hong Kong Stock Connect, which will remove limits imposed on foreign investors in the Shenzhen stock market, marks a step toward financial liberalization after Chinese trading regulators tightened their control following market volatility.¹²¹ In a statement before the State Council, Chinese Premier Li Keqiang indicated that the link, which will reportedly be implemented by November 2016, seeks to “exert the geographic advantages of Shenzhen and Hong Kong, and enhance the cooperation between the mainland and Hong Kong.”¹²² Because Shenzhen is a center for China's emerging industries, the new link is expected to have greater appeal to global investors, particularly in sectors like technology, pharmaceuticals, and clean energy.¹²³ Shenzhen is already China's most active exchange, handling \$1.2 trillion in trading in July 2016, the second highest in volume globally behind only the New York Stock Exchange.¹²⁴ Mainland authorities will remove aggregate trading caps for both Shenzhen's and Shanghai's stock connects with Hong Kong,¹²⁵ but Shenzhen will inherit the same daily quotas as Shanghai's exchange system.¹²⁶

Hong Kong's Security Ties with Mainland China

Since the handover of Hong Kong to the PRC in 1997, the Chinese government has been responsible for Hong Kong's defense under Article 14 of the Basic Law and in accordance with the “one country, two systems” policy.¹²⁷ The PLA has stationed forces in the Hong Kong Garrison, and its presence has gradually expanded over time but has remained relatively discreet compared to its activities and operations in and around mainland China. Nonetheless, the PLA has worked to expand its outreach efforts to Hong Kong citizens in a number of areas, including the following:

- *Opening the garrison to Hong Kong citizens:* Continuing a legacy program from the British era,¹²⁸ the PLA hosts an annual

*For more on China's recent stock market volatility, see Nargiza Salidjanova, “China's Stock Market Melted Down Shakes the World, Again,” *U.S.-China Economic and Security Review Commission*, January 14, 2016.

“open day” in which it usually opens several bases to Hong Kong citizens for military demonstrations, souvenir giveaways, and other activities.¹²⁹ The PLA reported that as of 2015, a total of 587,000 Hong Kong citizens had attended.¹³⁰

- *PLA outreach to young people:* The PLA hosts military summer camps for Hong Kong teenagers to teach them about PLA military life and mainland China. Around 500 students participated in the 2016 edition, twice as many as the previous year.¹³¹ The PLA also occasionally visits Hong Kong schools and civic groups. In December 2015, PLA personnel visited a kindergarten class to help the students make holiday presents for the elderly as part of the PLA’s “Care for Young Children” campaign.¹³²
- *Participating in Hong Kong community outreach:* PLA soldiers regularly participate in Hong Kong Tree Planting Day and blood donation activities. As of 2015, the PLA reported that garrison soldiers have planted 82,000 trees and over 6,800 troops have given blood.¹³³
- *Delivering messages through its information office:* The garrison issues messages to Hong Kong citizens, usually around the Lunar New Year, to support developmental initiatives key to Beijing. In February 2016, the garrison’s commander and political commissar issued a Lunar New Year’s greeting through the garrison’s information office, emphasizing that Hong Kong take advantage of the Mainland’s “One Belt, One Road” initiative and 13th Five-Year Plan.¹³⁴

The PLA’s Hong Kong Garrison has also conducted increasingly complex military exercises in recent years (see Table 1). Many of these exercises have occurred during particularly sensitive times in Hong Kong, causing prodemocracy advocates and other observers to assert that the CCP is using the PLA as a tool to apply pressure on Hong Kong citizens to fall in line with Beijing’s demands.¹³⁵

Table 1: Select PLA Hong Kong Garrison Exercises, 2011–October 2016

Date	Exercise Type (Name, if applicable)	Platforms and Services Involved (if reported)	Details and Perceived Political Sensitivity (if reported)
August 2016	Special Forces Exercise	Not reported	The exercise, which took place in Hong Kong, involved air, land, and sea drills, and urban combat using live ammunition. Although the dates of the five-day exercise are unclear, Chinese media broadcast video from the exercise the day before Hong Kong’s first pro-independence rally. ¹³⁶

Table 1: Select PLA Hong Kong Garrison Exercises, 2011–October 2016—Continued

Date	Exercise Type (Name, if applicable)	Platforms and Services Involved (if reported)	Details and Perceived Political Sensitivity (if reported)
2015 (various)	“Defenders of Hong Kong” Exercises	PLA Army, Navy, and Air Force	Four live-fire exercises held from May to October 2015 covered maritime defense, air defense, army-air operations, and joint operations. The July exercise was the first exercise ever open to the public, ¹³⁷ and occurred three days after China passed a new national security law that emphasized Hong Kong’s responsibility to defend China’s national security. The October exercise was intended to improve joint operational capabilities, while some Hong Kong media reported that it appeared targeted at pro-independence groups. ¹³⁸
1/24/2014	Sea-Air Joint Patrol	Two frigates and three helicopters	The patrol through Victoria Harbor (between Hong Kong Island and Kowloon) was staged less than one month after anti-PLA protests.* ¹³⁹
7/4/2013	Sea-Air Joint Patrol	Two Type 056 frigates and four armed rescue helicopters	Frigates newly introduced in early 2013 participated in the joint patrol, which was staged several days after the annual July 1 prodemocracy march. ¹⁴⁰
3/24/2013	Live-Fire Helicopter Exercise	Helicopters	The exercise was the first live-fire exercise in Hong Kong since 1997. It reportedly involved simulating the response to an external attack. ¹⁴¹
10/24/2012	Anti-Separatist Exercise	Helicopters, armored vehicles, and surface ships (PLA Army, Navy, and Air Force)	The exercise reportedly simulated armed combat against a “blue force” Cantonese-speaking army in an urban environment and included the seizure of a mountainous area outside the city. ¹⁴²
3/9/2011	Sea-Air Joint Patrol	PLA Army, Navy, and Air Force	The patrol involved surveillance, reconnaissance, and target tracking as well as sea and air emergency response. ¹⁴³

*For more information on the protests surrounding the building of a Chinese military port, see U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 528–529.

China Denies U.S. Navy Flotilla Port Call in Hong Kong

In April 2016, Beijing refused to allow the U.S. aircraft carrier *John C. Stennis* and supporting vessels a routine port call at the Hong Kong Garrison for the first time since August 2014. The decision to reject the U.S. Navy flotilla appeared to be in response to U.S. Navy freedom of navigation operations in the South China Sea challenging China's claims and those of other claimants.¹⁴⁴ Since 2013, an average of 14 U.S. Navy ships per year made port calls in Hong Kong,¹⁴⁵ and China has only refused U.S. port visits four times since the handover of Hong Kong to the PRC in 1997.¹⁴⁶

Implications for Taiwan of Beijing's Control over Hong Kong's Political Development

As Beijing's actions to restrict Hong Kong's autonomy intensify and the Hong Kong prodemocracy movement grows increasingly pessimistic about mainland China's control over Hong Kong—especially given its disregard for rule of law and lack of concessions on electoral reform—Taiwan activists are watching these developments with concern. In the event Taiwan could be brought under the “one country, two systems” framework in the future, which is Beijing's preferred model for Taiwan,¹⁴⁷ it would likely encounter similar encroachment on its democratic values and system of government. Mainland China's recent actions violating its commitments under the 1997 Sino-British Joint Declaration—the handover agreement of Hong Kong from the UK to the PRC—and reflected in the Basic Law to allow “a high degree of autonomy” in Hong Kong¹⁴⁸ do not bode well to achieve its goal of reunifying Taiwan with mainland China. Moreover, Taiwan has already rejected any potential framework similar to Hong Kong. According to Ma Ying-jeou, Taiwan's president from 2008 to 2016 who presided over a period of positive cross-Strait ties, “Taiwan [has] made it very clear that we would not accept [the “one country, two systems” formula]. If between two systems one is better, that system should prevail.”¹⁴⁹ During the Commission's trip to Taipei in June 2016, several Taiwan interlocutors emphasized that Taiwan citizens and the Tsai Ing-wen Administration do not want a relationship with mainland China resembling Hong Kong's “one country, two systems” model.¹⁵⁰ (See Chapter 3, Section 2, “China and Taiwan,” for more information on developments in Taiwan.)

Implications for the United States

U.S. policy toward Hong Kong remains based upon the U.S.-Hong Kong Policy Act of 1992, which outlines U.S. support for Hong Kong's democratization, human rights, and autonomy under the “one country, two systems” framework. Advocating for freedom of expression and democratic ideals serves as an important pillar of U.S. policy in the Asia Pacific. The 2016 LegCo elections serve as a vivid example of Hong Kong's democratic progress, particularly in resisting interference from Beijing. A spokesperson for the U.S. Department of State Bureau of East Asia and Pacific Affairs said, “[The record turnout was an] affirmation of the commitment of [the Hong Kong] people to participate in the democratic process.

[The Obama Administration] looks forward to working with all elected leaders to build strong relations between the United States and Hong Kong and achieve mutually beneficial goals.”¹⁵¹ However, the recent downward trends in Hong Kong with regard to electoral reform, press freedom, and academic freedom run counter to U.S. interests and values.

The case of Hong Kong—particularly as it relates to the booksellers incident and encroachment on press and academic freedoms, and the new loyalty “pledge” required for legislative candidates—reflects a broader pattern of behavior in which Beijing disregards norms, agreements, or laws (either in spirit or in letter) in pursuit of its objectives. It calls into question Beijing’s ability to retain its commitments to its neighbors. This is especially relevant when it comes to China’s commitment not to encroach on Taiwan’s autonomy, which in recent years has been increasingly threatened. The United States and Asia Pacific countries are already concerned about Beijing’s assertive actions in the region more broadly, particularly its island building in the South China Sea and aggressive behavior defending its claims, including by violating the spirit of the UN Convention on the Law of the Sea, to which China is a signatory.

Moreover, Hong Kong’s traditional standing as a global financial hub has significant economic implications for the United States, as U.S. trade and investment ties with Hong Kong are substantial. Hong Kong is the ninth-largest importer of U.S. goods, and the United States retains its largest trade surplus with Hong Kong (\$35.1 billion), according to 2014 data.¹⁵² U.S. FDI in Hong Kong ranked sixth in the world as of year-end 2014 (HKD 385 billion, \$49.6 billion).¹⁵³ In addition, Hong Kong is home to more than 1,400 U.S. firms, which depend on Hong Kong’s supportive business environment.¹⁵⁴ At the multilateral level, Hong Kong is a helpful participant alongside the United States in key international economic institutions, including the World Trade Organization, Asia-Pacific Economic Cooperation, the Financial Action Task Force on money laundering, and the Financial Stability Board on monitoring the global financial system.¹⁵⁵

Nonetheless, many in the Hong Kong business community, including U.S.-based and global firms, are beginning to question Hong Kong’s future as a global financial center due to the deterioration of the “one country, two systems” model, particularly as a result of the booksellers incident over the past year.¹⁵⁶ According to an executive at a foreign chamber of commerce in Hong Kong, “For many businesses, the [booksellers] incident has raised many questions about the rule of law, which is one of the absolutely key aspects that makes Hong Kong work and gives people the confidence to do business here.”¹⁵⁷ In February 2016, after months of deliberation, UK bank HSBC ultimately decided not to move its headquarters from London to Hong Kong; the decision was likely influenced in part by the lack of confidence in the maintenance of the “one country, two systems” framework in Hong Kong.¹⁵⁸ The chill felt across the Hong Kong business sector could negatively impact U.S. interests if the present climate persists.

Conclusions

- In the highest voter turnout to date for the 2016 Legislative Council elections, Hong Kong citizens rejected Beijing's heavy-handed efforts to limit support for prodemocracy candidates, resulting in the pan-democrats winning 30 out of 70 total seats (a net gain of three) and maintaining their ability to block pro-Beijing legislation. The election of five candidates from political parties founded in the aftermath of the 2014 Occupy protests demonstrated progress in Hong Kong's democratic development, particularly the increasing involvement and influence of young people in the political process.
- The case of the five Hong Kong sellers of political gossip books banned in mainland China who appeared to have been abducted and detained by Chinese authorities led many, including those not previously concerned, to call into question the state of Hong Kong's ability to maintain its independent legal system; Hong Kong's autonomy under the "one country, two systems" model; and the city's standing as a global financial center. Although long-term impacts are unclear at this time, the incident has already caused a chill throughout the book publishing industry, leading to bookstore closures and increased self-censorship.
- Beijing's refusal in 2014 to allow democratic reforms to the chief executive nomination process along with increased pressure on Hong Kong's political discourse over the past year, have led to greater disillusionment and pessimism among Hong Kong prodemocracy advocates regarding China's commitment to the "one country, two systems" framework.
- Hong Kong continues to face pressure on press and academic freedoms guaranteed under its mini constitution, the Basic Law. Schools in Hong Kong are facing increasing pressure, limiting open debate about democratic ideas and independence. Chinese e-commerce giant Alibaba's acquisition of the Hong Kong-based English-language newspaper *South China Morning Post* demonstrated Beijing's increasing reach into Hong Kong. Hong Kong citizens and international press freedom watchdogs have expressed their concern regarding these developments.
- In 2016, Hong Kong played an increasing role in Beijing's push to internationalize the renminbi. Although the existing Shanghai-Hong Kong Stock Connect has not lived up to expectations thus far due in part to regulatory deficiencies, as it matures over the coming years the platform could help facilitate greater investment into mainland stock markets. In November, Beijing plans to establish a second stock connect between Shenzhen and Hong Kong, which is expected to have greater appeal to global investors as Shenzhen is a base for the Mainland's emerging industries and its most active stock exchange.
- As Hong Kong's sole provider of defense under the Basic Law, the People's Liberation Army (PLA) has retained a relatively low-key presence, but has gradually expanded its outreach efforts to Hong Kong citizens. The PLA has also conducted increasingly sophisticated exercises in recent years, particularly during sen-

sitive periods in Hong Kong, leading some to accuse Beijing of using the exercises to pressure Hong Kong citizens.

- China's efforts to exert influence over Hong Kong in ways that undermine Hong Kong's autonomy under the Basic Law reflect a broader pattern of reliance on tools of pressure and coercion—rather than norms, laws, and agreements—to advance its interests vis-à-vis its neighbors. This pattern is also evident in China's relations with Taiwan and its recent behavior in the South China Sea.
- Hong Kong's standing as a global financial hub has significant economic implications for the United States, as U.S. trade and investment ties with Hong Kong are substantial. Nonetheless, some observers in Hong Kong are beginning to question its future as a global financial center due to the deterioration of the "one country, two systems" framework resulting in large part from the booksellers incident over the past year.

RECOMMENDATIONS

China and Hong Kong

The Commission recommends:

- Congress express that China's apparent abduction and detention of five Hong Kong and foreign national booksellers based in Hong Kong for selling banned books to customers in mainland China violates its commitments to maintaining a "high degree of autonomy" in Hong Kong under the "one country, two systems" framework. In addition, members of Congress in their meetings in China should continue to express support for human rights and rule of law in Hong Kong.
- Congress continue to renew annual reporting requirements of the U.S.-Hong Kong Policy Act of 1992, in an effort to ensure policymakers have the most up-to-date and authoritative information about developments in Hong Kong.
- Congress direct the U.S. Department of State to prepare a report that assesses whether Hong Kong has maintained a "sufficient degree of autonomy" under the "one country, two systems" policy, due to the deterioration of freedom of expression in Hong Kong and Beijing's increasing encroachment.

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SECTION 4: CHINA AND NORTH KOREA

Introduction

On September 9, 2016, North Korea conducted its fifth nuclear test—its second in 2016 and most powerful to date. The test follows a period of increased provocations under Kim Jong-un in defiance of the international community and North Korea's neighbor and closest partner, China. Since 2012, when Chinese President and General Secretary of the Chinese Communist Party (CCP) Xi Jinping assumed leadership and Kim Jong-un emerged as the leader of North Korea, China-North Korea relations have become increasingly strained. This downturn has largely been due to the Kim regime's increased belligerence and rejection of the international community's efforts to coax North Korea to denuclearize. Since then, bilateral relations have been characterized by growing frustration and downgraded diplomatic ties. In response to Pyongyang's fourth nuclear test in January 2016, China in March increased pressure on North Korea by agreeing to the most stringent UN resolution on North Korea to date.¹ As of the publication of this Report, the UN Security Council was negotiating a new resolution, which appears likely to further tighten economic sanctions, presenting Beijing with another opportunity to join the international community in meaningfully punishing Pyongyang's behavior.

It is too soon to fully evaluate China's implementation of the March sanctions, but apparent gaps in enforcement have already emerged. Moreover, the decision by South Korea and the United States to deploy the United States' Terminal High Altitude Area Defense (THAAD) ballistic missile defense system in South Korea by late 2017 has led China to interrupt what had been a period of increasingly friendly China-South Korea relations and obstruct international and regional cooperation on North Korea, though the long-term effects of the THAAD deployment are unclear.² Despite Pyongyang's increasingly aggressive behavior, the overall direction of Beijing's North Korea policy is unlikely to change. China has consistently sought to manage relations with North Korea, prioritizing stability by supplying Pyongyang with critical resources and hard currency, and helping to preserve the Kim regime in order to maintain a strategic buffer between China and U.S.-allied South Korea. This divergence between U.S. and Chinese strategic objectives on the Korean Peninsula is why perpetual U.S. hopes that China will use its supposed leverage to compel change in North Korea have not been fulfilled.

This section discusses the basis of the China-North Korea relationship, drivers of China's North Korea policy, China's evolving policies and perceptions regarding North Korea, China's enforcement of UN sanctions and its economic ties with North Korea, and the implications of the changing relationship for the United

States.* It is based on open source research and analysis and consultations with U.S. and foreign nongovernmental experts.

Overview of Contemporary China-North Korea Relations

Contemporary diplomatic relations between China and North Korea (the Democratic People's Republic of Korea, or DPRK) are founded on the shared experience of fighting against Japan starting in the 1930s, Communist Party ties dating back to the 1920s, shared wartime camaraderie from fighting together during the Korean War (1950–1953), and the 1961 Treaty of Friendship, Co-operation and Mutual Assistance.³ The treaty states that each party should “adopt all measures to prevent aggression against either [country] by any state,” and it includes a mutual defense clause, though some Chinese observers question China's commitment to North Korea's defense in a contingency.⁴ Each country is the other's only formal treaty ally. The relationship is based on party-to-party ties, shared distrust of the West, and proximity, among other factors.⁵

China's economic, diplomatic, and military support for North Korea is driven by its overarching goal of maintaining sufficient stability in North Korea to ensure the Kim regime's survival and preserve a strategic buffer between itself and U.S.-allied South Korea (the Republic of Korea, or ROK).⁶ In terms of economic support, China provides North Korea with most of its critical energy and food resources.⁷ It also funds and operates free trade zones near the border and supports infrastructure projects designed to improve connectivity between the two countries (for more on economic relations, see “North Korea Remains Economically Dependent on China,” later in this section).⁸ As for diplomatic support, China uses its position on the UN Security Council to protect North Korea from international criticism and to reduce the impact of economic sanctions, and often opposes unilateral U.S. sanctions, as well as regional and international condemnations against the North.⁹ In terms of dual-use and defense assistance, Chinese firms have sold components and materials to North Korea that could be used for military applications, including ballistic missiles.[†]¹⁰ (See “Gaps in China's Enforcement of UNSCR 2270” for more information on recent dual-use transfers to North Korea.)

* For the Commission's previous reporting on China-North Korea relations, see Michael Pilger and Caitlin Campbell, “Diminishing China-North Korea Exchanges: An Assessment,” *U.S.-China Economic and Security Review Commission*, March 23, 2015; U.S.-China Economic and Security Review Commission, Chapter 3, Section 2, “Recent Developments in China's Relationship with North Korea,” in *2014 Annual Report to Congress*, November 2014, 446–469; U.S.-China Economic and Security Review Commission, *2013 Annual Report to Congress*, November 2013, 228–229; and U.S.-China Economic and Security Review Commission, *2011 Annual Report to Congress*, November 2011, 241–252.

† For example, in October 2015, North Korea displayed guided artillery rockets mounted on vehicles imported from China. The Chinese government claimed the vehicles were exported with a clause stating the vehicles were only for “forest area operations and timber transportation.” The UN Panel of Experts tasked with investigating sanctions enforcement against North Korea reaffirmed the recommendation it made in its 2013 report—involving a similar case of a Chinese vehicle being sold and converted into a transporter-erector-launcher—that member states should “exercise vigilance” over exporting heavy vehicles. UN Security Council, *Report of the Panel of Experts Established Pursuant to Resolution 1874* (2009), February 24, 2016, 39–40; UN Security Council, *Report of the Panel of Experts Established Pursuant to Resolution 1874* (2009), June 11, 2013, 26–28.

From North Korea's perspective, while it needs Chinese support—particularly economic assistance—for the survival of the Kim Jong-un regime, Pyongyang resents this near complete dependence and has longstanding frictions with Beijing.¹¹ North Korea distrusts China, which it feels has abandoned Marxist-Leninist principles and become morally corrupted by capitalism and its relations with South Korea and the United States.¹² For its part, China views North Korea as a backward country.¹³ Beijing resents the accumulation of Pyongyang's provocations—particularly nuclear and ballistic missile tests violating UN resolutions—which it fears will lead to further instability on the Korean Peninsula and could heighten the risk of a major conflict in the region.¹⁴ Relatedly, Beijing likely views North Korea's continued belligerence against South Korea as strengthening Seoul's alliance with Washington and bolstering the U.S. military presence in Northeast Asia.¹⁵ While these frictions persist, Beijing's aversion to punishing Pyongyang—even in the face of increasing provocations—conveys China's perception that the preservation of the North Korean state and the Kim dynasty is essential to China's interests.

Recent Developments in China-North Korea Relations

Since President Xi took office in late 2012, persistent North Korean belligerence has contributed to a noticeable downturn in China's relations with North Korea. This trend continued in 2016 when, after North Korea's fourth nuclear test, China supported the most stringent UN Security Council resolution to date on North Korea. Beijing also condemned North Korea's September nuclear test and pledged to work with the United States and other UN Security Council members to further tighten North Korea sanctions. Alongside China's support for increased sanctions, a sustained drop in high-level contacts between China and North Korea has continued, and unlike in years past, public statements disseminated in the media and by government officials on both sides do not appear to convey an impression of particular closeness or cooperation. These developments suggest China has grown increasingly frustrated with North Korea's behavior in recent years. However, the recent decision by South Korea and the United States to deploy a THAAD ballistic missile defense system battalion in South Korea appears to be reinforcing Beijing's long-held suspicion of U.S. intentions on the Korean Peninsula.

North Korea Continues Provocations and Conducts Its Fourth and Fifth Nuclear Tests

The China-North Korea relationship has deteriorated during the Xi Administration, attributable largely to Pyongyang's weapons-testing-related activities: North Korea launched a satellite using ballistic missile technology in December 2012 and conducted its third nuclear test several months later; both activities occurred during China's sensitive leadership transition and despite Beijing's repeated warnings to Pyongyang against such provocations.¹⁶ According to Scott Snyder, senior fellow at the Council on Foreign Relations, China downgraded bilateral ties in 2013 from a "special"

relationship to “normal relations between states.”* Persistent tests of short- and medium-range ballistic missiles and systems using ballistic missile technology followed, violating UN resolutions.¹⁷ Then in January 2016, North Korea conducted its fourth nuclear test, another violation of UN sanctions.[†]¹⁸ Notably, unlike it did with previous nuclear tests, Pyongyang did not give Beijing advance warning about the fourth test.¹⁹

Following a series of missile and weapons systems tests demonstrating alarming progress (discussed in detail later in this section), in September 2016 North Korea conducted its fifth nuclear test, which was the most powerful to date.[‡] Previously, North Korean nuclear tests were conducted once every three to four years.²⁰ Beijing did not confirm or deny that Pyongyang provided it advance notice of the fifth test, but some analysts suspect a high-level North Korean diplomat who traveled to Beijing just prior to the test warned Chinese officials.²¹

Beijing’s initial diplomatic reaction to North Korea’s January 2016 nuclear test was restrained and similar to its reaction to North Korea’s 2013 test: China issued a statement expressing its opposition to the test and summoned the North Korean ambassador.²² Beijing also appeared cautious in applying further pressure on North Korea. Several weeks after the nuclear test, Chinese Foreign Minister Wang Yi agreed with U.S. Secretary of State John Kerry that new sanctions were necessary but that China believed the resolution “should not provoke new tensions.”²³ In February 2016, after Wu Dawei, China’s Special Representative for Korean Peninsula Affairs, traveled to Pyongyang and was reportedly unable to convince Kim Jong-un to stop provocations, President Xi had a phone conversation with South Korean President Park Geun-hye—the first consultation between leaders of the two countries following a North Korean nuclear test—but reportedly disagreed with the South Korean president on how to proceed.²⁴ In contrast to the January nuclear test and other previous tests, China’s initial response to the September 2016 nuclear test was more forceful, though at the time this Report was published China had yet to take concrete steps to punish Pyongyang. Beijing summoned the North Korean ambassador²⁵ and issued a statement expressing its opposition to the test just as it did earlier. However, Beijing’s statement for the first time called on North Korea to “comply with the relevant resolutions adopted by the United Nations Security Council” in addition to stating that China would “work together with the

* After the downgrade in relations with Pyongyang, Kim Jong-un’s purge and execution of his uncle and high-level official Jang Song-taek in December 2013 caused further deterioration in China-North Korea ties. Mr. Jang’s purge was reportedly due to his support for China-like economic reforms in North Korea and his increasing influence in the North Korean leadership. Mr. Jang was particularly close to China and important in facilitating North Korea-China economic ties. Scott A. Snyder, “Will China Change Its North Korea Policy?” *Council on Foreign Relations*, March 31, 2016; U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 449.

† Pyongyang claimed it successfully tested a hydrogen bomb, but nuclear experts denied the claim and confirmed the bomb’s yield was just slightly more powerful than previous tests. Stella Kim, Eric Baculinao, and Jason Cumming, “North Korea Says It Successfully Conducted Hydrogen Bomb Test,” NBC News, January 6, 2016.

‡ North Korea claimed that the test demonstrated its ability to miniaturize warheads to mount atop ballistic missiles, and analysts largely concurred with Pyongyang’s claims. Seyoon Kim, Hooyeon Kim, and Shinhye Kang, “North Korea Says Tested Nuclear Bomb, Can Miniaturize Arms,” Bloomberg, September 9, 2016; Zack Beauchamp, “The Textbook Definition of Unstable: Why North Korea’s Newest Nuclear Test Is Scary,” *Vox*, September 9, 2016.

international community to steadfastly push forward the goal of denuclearization.”²⁶ Several weeks after the nuclear test, Chinese Premier Li Keqiang met with U.S. President Barack Obama, and they agreed to strengthen coordination on achieving denuclearization of the Korean Peninsula by bolstering cooperation on North Korea in the UN Security Council and “in law enforcement channels.”²⁷

UN Security Council Responds to North Korea’s January 2016 Nuclear Test

After weeks of negotiations, China in March 2016 joined the United States and other UN Security Council members to unanimously pass UN Security Council Resolution (UNSCR) 2270—the toughest set of sanctions on North Korea to date.²⁸ Upon signing on to the resolution, a spokesperson from the Ministry of Foreign Affairs stated China’s reasoning for supporting the sanctions: “The Chinese side believes that the DPRK’s recent nuclear test and satellite launch violated [UN Security Council resolutions]. It is necessary for the UN Security Council to pass a new resolution on curbing the DPRK’s capabilities to develop nuclear and missile programs.”²⁹ China’s representative to the UN Liu Jieyi also reiterated that another reason for agreeing to the new set of sanctions was to compel North Korea to resume dialogue and negotiations on its nuclear program.³⁰

Several factors and perceptions may have influenced China’s decision: (1) impatience with Pyongyang’s belligerence—particularly in the face of Chinese requests to halt provocations—and fear that further provocations would invite unwanted enhancements in the U.S., South Korean, or Japanese military position in the region; (2) desire to avoid perceptions that it is shielding North Korea or is out of step with the international community, which unanimously and vociferously condemned the launch; and (3) concern about the impact a viable North Korean nuclear threat would have on stability on the Korean Peninsula. According to Balbina Hwang, a visiting professor at Georgetown University and American University, “The primary driver behind China’s decision to sign on to UN sanctions had little to do with North Korea itself; rather, Beijing saw an opportunity to ameliorate the U.S.-China relationship, which had been experiencing high levels of tension related to developments in the South China Sea and cyber espionage.”³¹ As of the publication of this Report, the UN Security Council was deliberating over a new UN resolution on North Korea, and these same factors and perceptions almost certainly will influence Beijing’s negotiations and decision regarding the probable resolution.

UNSCR 2270 targets North Korea’s diplomatic and commercial activities that are used to fund and help conceal its nuclear and ballistic missile activities, and includes the following key components that expand on previous resolutions:*

- *Requires cargo inspections and enhanced maritime procedures:* All countries are obligated to inspect cargo to and from North

*For a list of each component of UN Security Council Resolution 2270, see United States Mission to the United Nations, *Fact Sheet: DPRK Resolution 2270 (2016)*, March 2, 2016. For the full text of the resolution, see UN Security Council, *Resolution 2270 (2016)*, March 2, 2016.

Korea. The resolution also bans North Korean chartering of ships and planes.

- *Bans trade of key energy and mineral resources:* The resolution bans the export of coal, iron, and iron ore from North Korea, except those for “livelihood purposes” (those determined not to generate revenue for North Korea’s nuclear and ballistic missile development). Although the vague “livelihood purposes” language presents a significant loophole, as it is nearly impossible to prove or disprove whether these export revenues are augmenting prohibited North Korean activities,³² the resolution marks the first time these commodities have been included in UN Security Council sanctions on North Korea.³³ Rare earth element exports from North Korea are also banned, in addition to the transfer of aviation fuel (including rocket fuel) to North Korea.
- *Targets North Korean proliferation networks:* The resolution requires countries to expel North Korean diplomats engaged in activities that violate UN resolutions. It also includes a requirement for countries to expel foreign nationals who aid North Korea in evading sanctions and to close offices of designated North Korean entities and expel their representatives.
- *Imposes financial sanctions targeting North Korean banks and assets:* Countries are prohibited from allowing North Korean banks to open branches (or any related activity) and from allowing their own banks to operate in North Korea. The resolution also restricts a range of public and private financial support for North Korea and requires countries to close any North Korean financial institutions or affiliates that could contribute to its nuclear or ballistic missile programs or violations of UN resolutions.³⁴

Overview of Unilateral U.S. Sanctions on North Korea in 2016 and Implications for China

Alongside UNSCR 2270, the Obama Administration, in accordance with the North Korea Sanctions and Policy Enhancement Act of 2016 (which became law in February 2016),³⁵ announced several sets of unilateral sanctions on North Korea in 2016, targeting the North Korean leadership and the country’s access to the global financial system. In June, the U.S. Treasury Department designated North Korea a “primary money laundering concern” under the Patriot Act, prohibiting non-U.S. banks and entities from processing U.S. dollar-denominated transactions on North Korea’s behalf.³⁶ This will primarily impact Chinese banks that do business with North Korean entities, and serves to tighten restrictions on North Korea’s foreign trade, although the impact of the measure is unclear at this time (the sanctions entered force in August 2016). In response to the sanctions, a spokesperson for the Chinese Embassy in Washington stated China’s opposition to unilateral sanctions, saying the sanctions should avoid aggravating tensions on the Korean Peninsula and

**Overview of Unilateral U.S. Sanctions on North Korea
in 2016 and Implications for China—Continued**

“must not affect and harm the legitimate rights and interests of China.”³⁷

Another set of sanctions, which appear to have a minimal impact on Chinese interests, are the July blacklisting of Kim Jong-un, ten other senior North Korean officials, and five North Korean government entities for overseeing crimes against humanity. The sanctions, resulting from findings in the U.S. State Department’s 2016 North Korea human rights and censorship report, freeze any assets of these officials and entities in the United States and ban any U.S. interaction with them.³⁸ The sanctions will have a minimal impact on North Korea—the targets have few, if any, assets in the United States—but they could lead other countries to impose similar sanctions on North Korea in the future. China previously attempted to block the UN Security Council from even discussing North Korea’s human rights abuses.³⁹

In September 2016, the U.S. Department of the Treasury for the first time sanctioned Chinese entities and individuals with economic ties to North Korea. Treasury designated Dandong Hongxiang Industrial Development Co. and four Chinese nationals who directed and managed the firm for sanctions evasion activities, froze their assets, and prohibited U.S. citizens from conducting business with them.⁴⁰ In addition, the U.S. Department of Justice indicted the individuals and entity for sanctions violations, conspiracy, and money laundering. It also filed a civil forfeiture action for funds in 25 Chinese bank accounts allegedly belonging to the firm and its front companies, effectively confiscating the money. Dandong Hongxiang Industrial Development Co. allegedly used front companies established in offshore jurisdictions and Chinese bank accounts to conduct U.S. dollar financial transactions with sanctioned North Korean entities through the U.S. banking system.⁴¹ (For more details on the case, see “Gaps in China’s Enforcement of UNSCR 2270,” later in this section.) Such actions could compel Beijing to increase regulatory measures on Chinese firms doing business with the Kim regime. However, China is also unlikely to severely cut off economic ties with North Korea, as doing so could lead to instability or regime collapse in the North (see “Differences between China and the United States on North Korea Policy,” later in this section).

Although it is still too early to judge the extent of China’s sanctions enforcement, certain areas of progress and gaps are evident thus far (detailed in “Gaps in China’s Enforcement of UNSCR 2270,” later in this section).

UN Security Council Formulates New Resolution Following North Korea’s September 2016 Nuclear Test

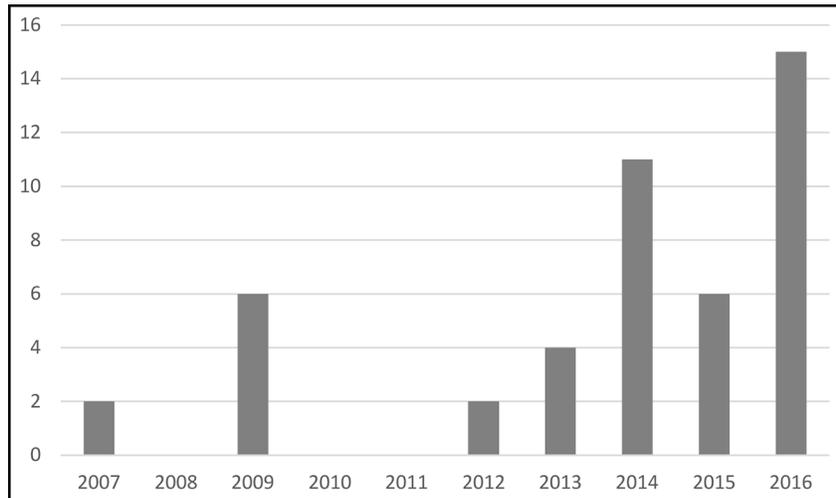
As of the publication of this Report, the UN Security Council was deliberating a new round of sanctions. It is almost certain that the new UN resolution will include measures beyond UNSCR 2270 to

increase pressure on Pyongyang. Some areas the resolution reportedly may target include closing the “livelihood purposes” loophole and preventing North Korea from sending its workers abroad, which are some of the largest sources of hard currency for the Kim regime.⁴²

North Korea Increases Frequency of Missile Tests

Since the January 2016 nuclear test, North Korea has conducted at least 19 missile tests involving 40 projectiles (as of October 20, 2016); among these tests, at least 15 have used ballistic missile technology—the most such tests in a single year in the past decade—and therefore violated UN resolutions (see Figure 1).⁴³

Figure 1: North Korea Missile Tests Violating UN Resolutions, 2007–October 2016



Note: Missile tests in this figure are defined as including all launches using ballistic missile technology in a single day. Tests in 2016 are current as of October 20, 2016.

Source: Ju-min Park and Eric Walsh, “Another North Korea Missile Test Fails after Launch, Says U.S. and South,” Reuters, October 20, 2016; Associated Press, “US, S. Korea Say Latest N. Korea Missile Launch Fails,” October 15, 2016; Victor Cha, “North Korean Provocations & US-ROK Military Exercises Dataset,” *CSIS Beyond Parallel Original Datasets*, September 2016. <http://beyondparallel.csis.org/database/>; and Japan’s Ministry of Defense, *North Korea’s Missile Launches in 2016*, September 9, 2016. Staff translation. http://www.mod.go.jp/j/approach/surround/pdf/dprk_bm_20160909.pdf.

In February 2016, before UNSCR 2270 was passed, North Korea launched a satellite—ostensibly for earth observation purposes—using ballistic missile technology, prompting a UN Security Council statement that condemned the launch for violating UN resolutions.⁴⁴ After North Korea’s submarine-launched ballistic missile test and failed intermediate-range ballistic missile tests in April 2016, Chinese state-run media accused North Korea of “sabre-rattling,”⁴⁵ and Beijing—together with its partners on the UN Security Council—pushed all parties to “strengthen implementation of the measures imposed in [UNSCR 2270].”⁴⁶

Although many of its tests in 2016 appeared to fail, in June North Korea alarmed U.S. observers and allies in Asia when it conducted an apparently successful launch of its Musudan intermediate-range ballistic missile,* which traveled 400 kilometers (250 miles). Following four failed Musudan tests earlier in the year, this launch demonstrated advancing capabilities that could eventually threaten Guam and other U.S. territories.⁴⁷ Meanwhile, China issued a mild rebuke in line with most of its responses to North Korean weapons tests, stressing that “relevant parties should avoid taking actions that may escalate the tension and make joint efforts to safeguard regional peace and stability.”⁴⁸ Demonstrating similarly significant progress in its missile development, North Korea in August conducted a submarine-launched ballistic missile test; the missile traveled over 500 kilometers (310 miles), covering a longer distance than previous tests and landing for the first time within waters inside Japan’s exclusive economic zone.† During the same month, North Korea launched an intermediate-range ballistic missile traveling approximately 1,000 kilometers (621 miles) into waters below Japan’s air defense identification zone.‡ These launches elicited strong concerns in Tokyo.⁴⁹ After reportedly blocking a UN Security Council statement condemning the first test that landed in Japan’s exclusive economic zone,⁵⁰ Beijing eventually conceded to join a statement denouncing both tests and several others from earlier in the year.⁵¹

High-Level Contacts between China and North Korea Remain Limited, but Engagement Efforts Persist

During the Xi Administration, high-level contacts§ between China and North Korea have been significantly less frequent than in previous years. According to open source reporting, only five high-level contacts have occurred between the two countries since the beginning of 2015⁵²—a decline from the seven contacts over the previous two-year period (which was already significantly lower than in years prior).¶⁵³ Meanwhile, President Xi has yet to meet with Kim Jong-un, which is particularly notable given that since taking office President Xi has conducted eight summit meetings with President Park and has expended considerable effort to ex-

*The Musudan has an estimated range of 3,500 km (2,175 mi). According to John Schilling, an expert on North Korea’s missile force at the Aerospace Corporation, a federally funded research and development center, at a minimum, the missile is accurate enough to hit Guam but does not have precise targeting capabilities. John Schilling, “A Partial Success for the Musudan: Addendum,” *38 North* (U.S.-Korea Institute blog), June 28, 2016; John Schilling, “A Partial Success for the Musudan,” *38 North* (U.S.-Korea Institute blog), June 23, 2016.

†An exclusive economic zone is a 200-nautical-mile zone extending from a country’s coastline, within which that country can exercise exclusive sovereign rights to explore for and exploit natural resources, but over which it does not have full sovereignty. UN Convention on the Law of the Sea, “Part 5: Exclusive Economic Zone,” Jun Ji-hye, “N. Korea Missile Lands in Japanese Waters,” *Korea Times* (South Korea), August 3, 2016.

‡An air defense identification zone, or ADIZ, is a publicly declared area, established in international airspace adjacent to a state’s national airspace, in which the state requires that civil aircraft provide aircraft identifiers and location. Its purpose is to allow a state the time and space to identify the nature of approaching aircraft before those aircraft enter national airspace in order to prepare defensive measures if necessary. Kimberly Hsu, “Air Defense Identification Zone Intended to Provide China Greater Flexibility to Enforce East China Sea Claims,” *U.S.-China Economic and Security Review Commission*, January 14, 2014.

§For the purposes of this Report, meetings in which at least one participant holds vice-ministerial rank or higher are considered high-level contacts.

¶According to open-source reporting, 30 high-level meetings occurred between 2011 and 2013. U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 451–452.

pand China-South Korea ties.⁵⁴ The steady decline in high-level contacts between China and North Korea in recent years is probably attributable to China's downgrading of relations in 2013 from a special relationship to normal state-to-state ties, as well as distrust between President Xi and Kim Jong-un.⁵⁵

Nevertheless, Beijing appears to have pursued some level of renewed diplomatic engagement since late 2015. Several prominent examples include the following:

- In October 2015, Chinese Politburo member and propaganda chief Liu Yunshan visited North Korean leader Kim Jong-un, the highest-level visit to Pyongyang by a Chinese official since 2013. During the visit at a military parade marking the 70th anniversary of the Workers' Party of Korea, the two held hands. The visit was interpreted as a sign of improved relations.⁵⁶
- In December 2015, North Korea's most famous pop band—whose members were reportedly handpicked by Kim Jong-un—had a series of concerts in Beijing canceled at the last minute, in what would have been the most prominent high-level cultural exchange between China and North Korea in years. According to Chinese observers, Kim Jong-un may have canceled the shows due to a lack of high-level Chinese officials planning to attend following his claim a day earlier that North Korea had developed a hydrogen bomb.⁵⁷
- In June 2016, North Korean envoy and Vice Chairman of the Central Committee of the Workers' Party of Korea Ri Su-yong made a surprise visit to Beijing and met with President Xi—the first such meeting between President Xi and a senior North Korean official since 2013.⁵⁸ The meeting occurred despite a failed North Korean intermediate-range ballistic missile launch a day earlier,⁵⁹ and Mr. Ri's provocative remarks the previous day in a meeting with other CCP officials that North Korea would continue to expand its nuclear arsenal and would not denuclearize.⁶⁰ During the meeting, President Xi said that China “attached great importance to developing a friendly relationship with North Korea” and was pursuing “calm” on the Korean Peninsula.⁶¹

These recent high-level contacts between China and North Korea suggest Beijing is seeking to inject some stability into the bilateral relationship to avoid further deterioration. The June 2016 meeting between President Xi and Mr. Ri was particularly telling of China's motivations, given the events immediately preceding the meeting. With growing international pressure on Pyongyang, Beijing likely will continue to pursue renewed diplomatic efforts to maintain stable bilateral ties in the near term, especially as China attempts to ease increasing tensions on the Korean Peninsula and bring North Korea to the negotiating table on denuclearization and a peace treaty (see “China's Increased Emphasis on Denuclearization,” later in this section).

The United States and South Korea Announce Ballistic Missile Defense System Deployment

Hours after North Korea's February 2016 satellite launch test using ballistic missile technology, South Korea announced it would pursue formal talks with the United States to deploy THAAD in South Korea due to the increased security threat posed by North Korea (see textbox later in this subsection for technical details of the system).⁶² In July, the two countries announced the decision to proceed with the deployment of a THAAD battery in South Korea by late 2017, at an estimated cost of \$1.6 billion.⁶³ Under the Status of Forces Agreement between the United States and South Korea, the United States will fund the battery's deployment and maintenance costs and contribute the necessary forces for operations, while South Korea will provide the land and facilities needed.⁶⁴

Beijing, which had been highly critical of the idea ever since media reports first mentioned U.S. officials were considering the deployment in May 2014,⁶⁵ appeared to be caught by surprise. In response to the THAAD announcement, a spokesperson for China's Ministry of Foreign Affairs said,

*China has expressed strong dissatisfaction with and firm opposition to the decision and has summoned the ambassadors of the U.S. and the ROK to lodge our representations. The deployment of the THAAD system by the U.S. and the ROK will in no way help achieve the goal of denuclearization on the Peninsula and maintain peace and stability of the Peninsula. It runs counter to the efforts by all parties to resolve the issue through dialogue and consultation and will gravely sabotage the strategic security interests of regional countries, including China, and [the] regional strategic balance. China strongly urges the U.S. and ROK to halt the process of deploying the system and refrain from complicating the regional situation or undermining China's strategic security interests.*⁶⁶

China views THAAD as a significant security risk, as it would expand U.S. radar coverage well into Chinese territory and could be used by the United States and its allies in a contingency involving China.⁶⁷ Moreover, given THAAD's interoperability with other missile defense systems in Northeast Asia, Beijing is concerned about the expanding U.S.-allied missile defense radar network in the region and closer intelligence sharing and broader strategic cooperation between the United States, South Korea, and Japan.⁶⁸ Beijing has dismissed repeated U.S. reassurances that THAAD would only be used to defend against the North Korean threat and would not be directed in any way at China.⁶⁹ U.S. Army Chief of Staff Mark Milley visited Beijing in August 2016 to provide a technical briefing on the system to People's Liberation Army (PLA) Army General Li Zuocheng, in an effort to reassure Beijing that its planned deployment will not threaten China.⁷⁰

Technical Details of THAAD

The exact configuration of the THAAD battery that will be deployed in South Korea is not known,⁷¹ but a single battery usually consists of six to nine truck-mounted launchers, 48 to 72 interceptors, a fire control and communications unit, and an AN/TPY-2 X-band radar.⁷² It takes an average of 30 troops to operate and is road-mobile, allowing for quick mobilization in a conflict.⁷³ THAAD is designed to intercept short- and medium-range ballistic missiles up to 200 kilometers (125 miles) away and up to 150 kilometers (93 miles) in altitude—far superior to other missile defense systems deployed in South Korea.⁷⁴ According to most estimates, THAAD's X-band radar has a range up to approximately 2,000 kilometers (1,243 miles) in "forward-based mode," which covers most of the eastern half of China.⁷⁵ However, using this mode would disable THAAD's missile intercept capability. U.S. defense officials have stated that the system will operate in "terminal mode," limiting the radar's range to 600 kilometers (373 miles), which would cover minimal Chinese territory near the China-North Korea border and part of Shandong Province.⁷⁶

On the day of North Korea's February 2016 satellite launch and the THAAD announcement, China separately summoned both the North Korean and South Korean ambassadors to China,⁷⁷ seeming to suggest that Beijing views THAAD as a security threat at least on par with that of Pyongyang's ballistic missile and nuclear programs, although China views THAAD through a different security lens than it does North Korea. Beijing sees THAAD as a direct threat to its national security, whereas it perceives North Korea as a more manageable and limited threat.⁷⁸

U.S. government officials and analysts argue Beijing's concerns are overblown, particularly those related to THAAD's X-band radar. Troy University professor Daniel Pinkston notes, "The U.S. does not need a radar in South Korea to acquire and track Chinese [intercontinental ballistic missiles] early in flight. There are two X-Band radars deployed in Japan, and sea-based tracking radars on Aegis ships are in the region as well. Furthermore, U.S. space-based early warning systems would detect a Chinese [intercontinental ballistic missile] almost immediately after it was launched."⁷⁹

It is unclear how the THAAD deployment will impact China's strategy toward the Korean Peninsula in the long term. U.S. and foreign observers suggest a number of potential outcomes: (1) China could align more strongly with Pyongyang in an attempt to counterbalance what it views to be an increasing regional security threat from the U.S.-South Korea alliance; (2) it could decide to expand enforcement of UN sanctions in an effort to reassure the United States and South Korea in hopes of demonstrating that the planned missile defense system in South Korea is unnecessary; or (3) it could seek to maintain the status quo and instead focus on the other flashpoints along its periphery, including the South China Sea, East China Sea, and Taiwan.⁸⁰

Regardless of whether or how China adjusts its policy in response to THAAD, the deployment has already led to an interruption in the recent warming of China-South Korea relations⁸¹ and to greater Chinese obstructions to international and regional cooperation on North Korea. For example, in August, some events and concerts featuring South Korean pop stars and television personalities were canceled, and several joint Chinese-South Korean television projects were postponed. Industry observers in both countries assessed that pressure from Beijing and Chinese firms' anticipation of Beijing's directives quashed these activities.⁸² According to Lee Jong-seok, a senior research fellow at South Korean think tank the Sejong Institute and former unification minister of South Korea in 2006, who visited the China-North Korea border area in August 2016, "Local sources [at the border] have said passage through Chinese customs have become much easier since the [South Korean] government announced its decision to deploy THAAD. ... [The] deployment decision appears to have relieved some of the psychological burden from the UN's sanctions against North Korea among Chinese people involved in economic relations with the North."⁸³ As mentioned earlier, China also reportedly blocked a UN Security Council resolution condemning North Korea's launch of a ballistic missile that landed for the first time in waters within Japan's exclusive economic zone,* insisting that the resolution include language denouncing the THAAD deployment.⁸⁴ Beijing's opposition to and suspicion of the THAAD deployment likely will impede cooperation with the United States and the region on issues related to North Korea. However, some U.S. experts assert the interruption of recent positive ties between China and South Korea probably will only be a short-term development due to robust bilateral economic relations.⁸⁵

Evolution in China's Policies and Perceptions Regarding North Korea

Debate in China on North Korea Policy

Chinese analysts occupy a wide spectrum of views on North Korea, and generally include "traditionalists" who favor Beijing's current policy supporting the Kim regime, "strategists" who support increased Chinese pressure on North Korea, and the "abandonment" school that calls for Beijing to withdraw support for Pyongyang.†⁸⁶ This division among foreign policy experts on North Korea demonstrates the complexity of the China-North Korea rela-

*In response to North Korea's increasing threat, Japan has renewed its pursuit of improved missile defense systems, which includes exploring the possibility of THAAD. As early as 2009, Japan considered THAAD as a possible solution. Julian Ryall, Gabriel Dominguez, and Neil Gibson, "Japan Considers Adding THAAD to its Air Defense Capabilities," *IHS Jane's*, August 12, 2016; Andy Sharp, "Japan Mulls THAAD Missile Defense System amid North Korea Threat," *Bloomberg*, November 24, 2015; and Reuters, "Japan Mulls New Missile Defense System—Media," July 5, 2009.

†During the Xi Administration, the public debate on North Korea among Chinese foreign policy experts has expanded. In addition, President Xi has allowed a diverse public debate among Chinese citizens. One Chinese scholar asserts, "[The] more that nuclear and missile provocations are committed by the DPRK, the more that the Chinese people cannot accept [North Korea's behavior]. ... Talking about North Korea openly and negatively used to be taboo in China, but that is no longer the case." Yu Tiejun, "The Significance of the Korean Peninsula in Xi Jinping's Global Strategy," in *Chinese Perspectives toward the Korean Peninsula: In the Aftermath of North Korea's Fourth Nuclear Test*, Stimson Center, June 2016, 18.

tionship and probably reflects a similar diversity of opinions among the Chinese leadership.⁸⁷

After the January 2016 nuclear test, the public debate among these experts appears to have been less active than after Pyongyang's previous nuclear test in 2013, during which the "abandonment" view gained some traction,⁸⁸ and concentrated among the strategist and traditionalist camps. Some in the strategist camp supported China's full implementation of UN Security Council resolutions.⁸⁹ Others in the traditionalist camp advocated for friendlier ties with North Korea and for the United States to avoid overly critical rhetoric and punitive actions toward North Korea.⁹⁰ Following the September 2016 nuclear test, a more active public debate emerged with the strategist and traditionalist camps again more vocal among Chinese experts. In alignment with the Chinese government's response to U.S. Secretary of Defense Ashton Carter that the United States—and not China—bears responsibility for North Korea's fifth nuclear test, many downplayed the leverage China has on North Korea and blamed the United States and South Korea (and its decision to deploy THAAD) for causing the test.⁹¹ On the other hand, a group of Chinese commentators supported continued pressure on North Korea through a combination of sanctions and dialogue.⁹²

China's Increased Emphasis on Denuclearization

Beijing's North Korea policy has always included advocating for denuclearization, but historically it has been least important among its three longstanding policy priorities of "no war, no instability, no nukes."*⁹³ Beijing has increasingly emphasized denuclearization as North Korean provocations have become more frequent in recent years, possibly signaling that China seeks a larger role in realizing a nuclear-free Korean Peninsula. High-level Chinese officials in meetings with their U.S. counterparts and Chinese Ministry of Foreign Affairs statements increasingly stress denuclearization over stability.⁹⁴ According to one Chinese analyst, China's prioritization of denuclearization was one of the main drivers compelling it to agree to a more stringent UN resolution in the aftermath of the January 2016 nuclear test.⁹⁵ Nonetheless, as Renmin University professor Shi Yinhong asserts, "Beijing ... [believes] that China must prevent the denuclearization process and its own role within it from seriously and lastingly damaging China-North Korea relations by becoming too alienated from the Pyongyang regime."⁹⁶

China's preferred method to accomplish this goal is through restarting the Six-Party Talks.† In the aftermath of North Korea's January 2016 nuclear test, a spokesperson for China's Ministry of Foreign Affairs said, "All relevant parties should return to the

*North Korea has repeatedly stated it will not give up its nuclear weapons program. In April 2016, North Korea's diplomat to the UN said, "Denuclearization should not be an objective of any future talks with us. We will never give up nuclear weapons before the U.S. and the world are denuclearized." Baik Sungwon, "N. Korean Envoy: Nuclear Weapons Not Negotiable," *Voice of America*, April 1, 2016.

†The Six Party Talks involving China, Japan, North Korea, Russia, South Korea, and the United States were established in 2003 to negotiate the termination of North Korea's nuclear program. After six rounds of negotiations, North Korea left the Six-Party Talks in 2009, and the negotiations have not resumed since. Jayshree Bajoria and Beina Xu, "The Six Party Talks on North Korea's Nuclear Program," *Council on Foreign Relations*, September 30, 2013.

right track of resolving the Korean nuclear issue through the Six-Party Talks as soon as possible with the larger picture of regional peace and stability in mind.”⁹⁷ President Xi himself has made numerous calls for resuming the Six-Party Talks, the most recent of which was on the sidelines of the September 2016 G20 summit in Hangzhou, China.⁹⁸ Pursuing this dialogue is beneficial to Beijing for many reasons: (1) it portrays China as a responsible stakeholder in the international community, and, if the talks can actually be revived, China will be able to take credit for it; (2) dialogue is preferable to instability and conflict (even in the event the Six-Party Talks are unsuccessful); and (3) it absorbs U.S. pressure for change in North Korea.⁹⁹

In addition to renewed diplomatic efforts to return to the Six-Party Talks, China has also proposed a dual-track strategy to bring North Korea to the negotiating table by seeking a peace treaty to replace the 1953 armistice agreement that marked a ceasefire in the Korean War*—a treaty North Korea has long sought†—alongside denuclearization.¹⁰⁰ In March 2016, Chinese Foreign Minister Wang Yi said these two goals “can be negotiated in parallel, implemented in steps, and resolved with reference to each other.”¹⁰¹ However, such an agreement appears highly unlikely to be realized anytime soon, given North Korea’s refusal to dismantle its nuclear program.¹⁰² While Beijing would like to see the peace treaty signed as a symbol of good faith to North Korea, Washington and Seoul insist that talks regarding a treaty would only happen if North Korea agrees to abandon its nuclear program first.¹⁰³

In August 2016, weeks before North Korea’s fifth nuclear test, in a trilateral meeting with the Japanese and South Korean foreign ministers, Minister Wang laid out a new formulation for China’s priorities on the Korean Peninsula of “three objections” and “three persistence[s]”: China opposes (1) North Korea’s nuclear weapon development, (2) any actions that cause tension on the Korean Peninsula, and (3) measures in violation of UNSCR 2270, and it continues to pursue (1) denuclearization of the peninsula, (2) dialogue and negotiation, and (3) the maintenance of peace and stability.¹⁰⁴ It is unclear how, if at all, these priorities and their dual approach of pursuing a peace agreement alongside denuclearization will change in the aftermath of the September test, but Beijing’s response thus far does not suggest a change in policy.

Gaps in China’s Enforcement of UNSCR 2270

As stated earlier in this section, it is too early to fully assess China’s enforcement of UNSCR 2270. Skeptics contend that Beijing

*The armistice agreement, which the United States, South Korea, China, and North Korea signed in 1953, was designed to act as a temporary ceasefire until all parties could agree on a peace treaty. It established the Korean Demilitarized Zone between the two Koreas that is still intact today. BBC, “The Korean War Armistice,” March 5, 2015; Council on Foreign Relations, “Korean War Armistice Agreement,” July 27, 1953.

†North Korea has offered to conclude a peace treaty in exchange for an end to U.S.-South Korea military exercises. According to Bruce Bennett, a senior defense analyst at RAND, Pyongyang probably views the peace treaty as a means to unify the Korean Peninsula under the North Korean regime because such a treaty would plausibly remove the necessity of U.S. forces to remain in South Korea. In this scenario, the United States would find it more difficult to redeploy forces to the region in a contingency. Bruce W. Bennett, “Kim Jong-un Is Trolling America Again,” *National Interest*, May 17, 2016; Reuters, “North Korea Says Peace Treaty, Halt to Exercises, Would End Nuclear Tests,” January 16, 2016.

will not completely enforce the sanctions and will take advantage of loopholes in UNSCR 2270, as its track record on previous UN resolutions on North Korea suggests.*¹⁰⁵ China has a history of strictly enforcing sanctions in the months immediately following new rounds of sanctions and then loosening enforcement.¹⁰⁶ Moreover, Beijing has used its seat in the UN Security Council to weaken past UN sanctions on North Korea, particularly in the years prior to North Korea's 2013 nuclear test,¹⁰⁷ although there is no public documentation that China used its position to dilute UNSCR 2270. However, sources assert that Beijing insisted on including language allowing for the vague exception to the sanctions' bans on exports of North Korean coal, iron, and iron ore for "livelihood purposes."†¹⁰⁸ This exception provides China (and other countries) an opportunity to flexibly enforce sanctions.

Still, early signs show that Beijing has made some progress in working to fulfill its commitments under the resolution. These signs include the following:

- *Chinese government agencies issue new regulations:* Just days after UNSCR 2270 passed in March 2016, China's Ministry of Transport ordered maritime agencies to bar from Chinese ports 31 North Korean boats operated by North Korean firm Ocean Maritime Management, which is sanctioned under the resolution. In addition, authorities in Dandong, a northeast Chinese city that borders North Korea, reportedly issued a restriction on the number of vehicles crossing each day via a bridge into North Korea from 300–400 to 100.‡¹⁰⁹ One month later, China's Ministry of Commerce, in compliance with UNSCR 2270, issued an embargo on coal and some other mineral exports to North Korea.¹¹⁰ Shortly thereafter, Chinese authorities reportedly increased customs inspections on all cargo crossing the border.¹¹¹ Following reports of a reopened plutonium processing facility in North Korea in June 2016, China's Ministry of Commerce, the Ministry of Industry and Information Technology, the China Atomic Energy Authority, and the General Administration of Customs issued new bans on dual-use items and technologies being exported to North Korea, in compliance with the sanctions.¹¹²

*For more information on China's enforcement of the UN sanctions enacted following the DPRK's 2013 nuclear test, see U.S.-China Economic and Security Review Commission, *2014 Annual Report to Congress*, November 2014, 456–457.

†Several days after the resolution passed, a spokesperson at China's Ministry of Foreign Affairs was the first to reference the exception. The spokesperson said, "The resolution prohibits the DPRK's export of coal, iron ore and iron, but those that are deemed essential for people's livelihood and have no connection with the funding of the DPRK's nuclear and missile programs will not be affected." In addition, China's Ministry of Commerce disseminated forms for Chinese firms to use when importing resources listed under this provision, allowing traders to continue buying embargoed minerals from North Korea. Russia also appeared to support UNSCR 2270's livelihood exception, among other exceptions. China's Ministry of Commerce, *Ministry of Commerce, General Administration of Customs Announcement No. 11 of 2016 Regarding the Embargoed Mineral Export List to North Korea Announcement*, April 5, 2016. Staff translation. <http://www.mofcom.gov.cn/article/b/c/201604/20160401289770.shtml>; China's Ministry of Foreign Affairs, *Foreign Ministry Spokesperson Hong Lei's Regular Press Conference on March 4, 2016*, March 4, 2016; and Radio Free Europe and Radio Liberty, "Russia Carved out Exceptions to North Korean Sanctions," March 3, 2016.

‡According to an expert on the North Korean economy, about 70 percent of economic activity between China and North Korea runs through Dandong and the surrounding region in northeast China. U.S. expert on North Korea's economy, meeting with Commission, May 26, 2016.

- *China bans North Korean remittances in Dandong*: Just hours before UNSCR 2270 passed, Chinese state-owned banks in Dandong froze all transfers of renminbi currency to North Korean banks in compliance with the sanctions. Since North Korea's 2013 nuclear test, Dandong banks have halted all U.S. dollar transfers.*¹¹³
- *China works with the United States to improve sanctions regime*: Several weeks after UNSCR 2270 passed, Beijing found that four North Korean ships were mistakenly included in the resolution's list of vessels banned from calling at international ports, thinking they were affiliated with sanctioned North Korean entity Ocean Maritime Management. China obtained written commitments that the ships would not use North Korean crews associated with the barred firm, and then worked with the United States to remove the four ships from the resolution's blacklist.¹¹⁴

These encouraging signs notwithstanding, it remains difficult to measure China's enforcement of UNSCR 2270 due to lack of Chinese transparency and detailed reporting mechanisms. For example, some level of cross-border trade (both legal and illicit) is known to persist without being counted in official Chinese trade figures.¹¹⁵ Moreover, coal trade—one of the most significant components of China-North Korea trade and a major source of hard currency for North Korea (the U.S. government estimates North Korean revenue from coal exceeds \$1 billion per year and accounts for about one-third of its total export income)[†]¹¹⁶—is problematic to measure. Regarding Chinese coal imports from North Korea, it is nearly impossible to tell whether the initial decline in shipments in the months after the implementation of UNSCR 2270 was driven by the sanctions or a result of unrelated factors, such as lower Chinese demand.¹¹⁷ According to Andrea Berger, deputy director of the Proliferation and Nuclear Policy Program at the Royal United Services Institute, a London-based think tank, “Financial flows from general commodity sales to prohibited programs are extremely difficult to prove in practice, meaning that China will be able to continue to buy large quantities of North Korean coal and argue that it is adhering to the resolution.”¹¹⁸

As of the publication of this Report, evidence suggests Beijing has not stopped the trade of all banned items and goods with North Korea and has not fully maintained its commitments under UNSCR 2270. As of July 2016, North Korean entities were using e-commerce website Alibaba to sell coal to the Chinese market.¹¹⁹ One month later, several South Korean analysts cited Chinese sources that observed eased cross-border inspections since the July THAAD deployment announcement, and noted increased economic

*Nonetheless, UNSCR 2270 and China's ban on North Korean remittances in Dandong appear to have resulted in the increased use of cash and local banks for transactions, according to an expert on the Korean Peninsula who spoke with the Commission. The expert assesses these smaller banks are less transparent and transactions at these institutions are more difficult to track. U.S. expert on the Korean Peninsula, meeting with Commission, May 26, 2016.

†As the world's largest coal consumer and producer, China is a major importer and exporter of coal. In its trade relationship with North Korea, China's demand for coal has dropped in recent years due to environmental regulations, and China has placed quality restrictions on North Korean coal it imports to meet certain environmental requirements. Laura Dattaro, “Here's How China Is Screwing North Korea's Economy,” *Vice News*, March 10, 2015.

activity at the China-North Korea border, including an increase in North Korean trucks entering China and signs of heightened smuggling operations.¹²⁰ In August, China imported a record amount of coal in a single month, amounting to a 74 percent jump compared to the same month in 2015, according to Chinese customs data.¹²¹ In addition, some barred vessels listed in UNSCR 2270 have been seen entering and leaving Chinese ports, while others have been observed operating close to Chinese ports and then disappearing from radar following the implementation of sanctions, which raises questions about whether these vessels were conducting banned trade with China.¹²² Aside from banned trade, China in 2016 bought approximately \$74.5 million worth of North Korean fishing rights—the largest such deal involving fishing areas between the two countries—providing Pyongyang with much needed hard currency.¹²³ The purchase could violate UN resolutions if Pyongyang uses the funds for its nuclear and ballistic missile programs.¹²⁴

Several recent studies illuminate how Chinese firms and individuals have colluded with North Korean entities to evade sanctions in the past. One report published in August 2016 by John Park and Jim Walsh, researchers at Harvard University and the Massachusetts Institute of Technology, respectively, who conducted interviews with a dozen defectors who worked at North Korean state-run procurement companies from 2010 to 2012, found North Korea's use of Chinese middlemen and shell companies to mask illicit trade has become increasingly efficient. In addition, the report found North Korean financial operations have become more embedded in China, and asserted that Chinese brokers working with North Korean entities may be using onshore bank accounts in China to evade sanctions targeting Pyongyang's access to foreign banks. North Korean firms have also taken advantage of Hong Kong's role as a financial hub in its business dealings with Chinese partners.¹²⁵ Another study published in September, by data analytics firm C4ADS and South Korean think tank the Asan Institute for Policy Studies, uncovered the aforementioned complex network of Chinese entities under a single conglomerate, Dandong Hongxiang Industrial Development Co., in the most significant case to date of a Chinese company found violating UN sanctions on North Korea:

*During the course of our investigation, we identified over \$500 million of imports and exports from the DPRK [over the last five years] associated with one specific Chinese trading conglomerate. Its subsidiaries and affiliated entities have transacted with sanctioned Burmese and North Korean entities, have been associated with North Korean cyber operators, and have traded in various goods and services that could represent serious proliferation concerns.*¹²⁶

Before announcing its charges against the firm and associated individuals, U.S. Department of Justice officials alerted Chinese authorities about the case. In September 2016, Beijing launched an investigation into the firm's alleged "serious economic crimes," and froze certain assets connected to the company.¹²⁷ Although this action showed encouraging progress in U.S.-China cooperation on tar-

getting Chinese firms violating sanctions, some U.S. officials reportedly expressed concern that their Chinese counterparts had not shared documents related to the case and may not be genuine in their announced efforts to investigate the firm.¹²⁸

North Korea Remains Economically Dependent on China

North Korea's economy is among the world's most constrained and least productive. According to Nicholas Eberstadt, a scholar at the American Enterprise Institute, North Korea's per capita trade after adjusting for inflation was lower in 2014 than in the mid-1970s.¹²⁹ Dr. Eberstadt asserts there are many reasons for this prolonged stagnation: "The DPRK has no rule of law; no established property rights; no possibility for private foreign trade; no reliable currency; virtually no official social and economic information; and no internal constraints whatever upon [the Kim regime]." ¹³⁰ Moreover, North Korea's business environment is one of the most restricted globally. This is reflected in the 2016 Index of Economic Freedom published by the Heritage Foundation and *Wall Street Journal*, which gave North Korea the worst score in the world among ranked countries.¹³¹ Such constraints severely limit countries' economic cooperation with North Korea, leaving China to fill the gap.

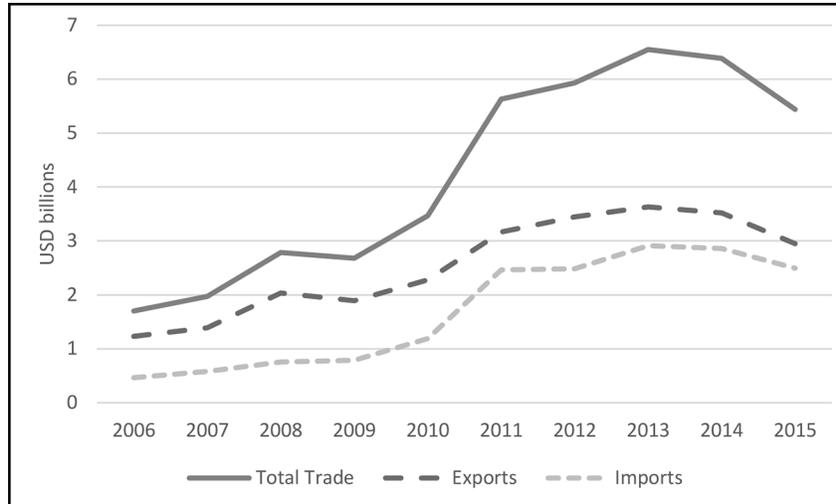
China's close economic ties with North Korea are unlikely to diminish significantly in the near term, despite the UN and international community monitoring Beijing's enforcement of UNSCR 2270. Total trade between the two countries has been falling since 2013 with much of the decline related to reductions in the value of mineral shipments, according to Chinese customs figures.¹³² With UNSCR 2270 covering much of the mineral trade (most importantly coal), total trade would be expected to decline further if China fully enforces the sanctions. According to Chinese trade data through August 2016 (the most recent as of the publication of this Report), total trade increased by 3.4 percent year-on-year since March when sanctions were implemented.¹³³

In 2015, China comprised approximately 91 percent of North Korea's legitimate foreign trade of \$6.25 billion (excluding trade with South Korea).¹³⁴ The February 2016 closure of the inter-Korean Kaesong Industrial Complex, where essentially all trade between North Korea and South Korea was transacted,¹³⁵ sustains China's dominant position. Official Chinese trade figures show China-North Korea trade in 2015 fell 14.7 percent from 2014 to \$5.4 billion, largely resulting from a decline in commodities prices, especially coal and iron ore.¹³⁶ Chinese exports to North Korea in 2015 were approximately \$2.9 billion, a decline of 16.4 percent from the previous year, while Chinese imports from North Korea were \$2.5 billion, a 12.9 percent decline from 2014 (see Figure 2).¹³⁷ North

*According to the South Korean government's trade promotion agency, Chinese exports to North Korea in 2015 were \$3.2 billion, a 20 percent decline from 2014, and Chinese imports from North Korea were \$2.4 billion, down 13 percent from 2014. These data account for an additional 500,000 tons of Chinese oil exports not included in China's customs data since China stopped counting oil in its trade data in 2014. To calculate the amount of extra Chinese exports to North Korea, the South Korean government statistics multiply the estimated 500,000 tons by the international price for oil in 2015. Korea Trade-Investment Promotion Agency, *2015*

Korea runs perpetual merchandise trade deficits primarily with China (and also Russia);¹³⁸ possible financing sources for these deficits include overseas business activities, illicit activities, foreign aid, and remittances.¹³⁹

Figure 2: China-North Korea Trade, 2006–2015



Source: China General Administration of Customs via CEIC database.

To help facilitate bilateral trade and tourism, North Korea has established 11 special economic zones (SEZs) near the North Korea-China border, which have been heavily promoted under Kim Jong-un, though most are not operational due to North Korea's business environment, bureaucratic constraints, and tensions in bilateral relations.¹⁴⁰ According to Curtis Melvin, a researcher at the U.S.-Korea Institute at the Johns Hopkins University School of Advanced International Studies, "North Korea's business environment is not a welcoming destination for Chinese capital even when relations are relatively good because with no credible commitment to policies, there is ultimately nothing preventing the DPRK from shaking down or seizing assets of Chinese investors at some point in the future when the bilateral environment changes."¹⁴¹ Beijing seeks to build improved infrastructure connecting some of these SEZs to China, but these projects have largely stalled in recent years.¹⁴² Lu Chao, director of the North and South Korea Research Center at the Liaoning Academy of Social Sciences in China, notes that cross-border economic development projects between Dandong and North Korea, including a \$338 million bridge linking Dandong (China) and Sinuiju (North Korea), have been delayed indefinitely by Pyongyang since December 2013 when Kim Jong-un purged and executed his uncle and high-level official Jang Song-taek, who was important in facilitating bilateral economic ties.¹⁴³

¹⁴⁰ *North Korea Foreign Trade Trends*, July 2016, 12; Analyst, Korea Trade-Investment Promotion Agency, interview with Commission staff, September 5, 2016.

Total Chinese investment in North Korea is unclear due to the lack of reliable data, but several analysts assess official Chinese investment accounts for approximately 95 percent of foreign direct investment in North Korea.¹⁴⁴ Chinese companies largely view the North Korean investment climate as difficult, opaque, and risky because of inadequate legal protections for foreign investors in North Korea and its poor infrastructure.¹⁴⁵ In addition to North Korea's SEZs, China operates a free trade zone in Dandong and two others are set to operate in the border region,* providing North Korea with another source of hard currency. According to public reports, Chinese citizens can buy a limited amount of North Korean goods duty-free within 20 kilometers of these areas.¹⁴⁶ An expert on the North Korean economy told the Commission that China has ambitious goals for expanding trade and investment through the Korean Peninsula by eventually expanding high-speed rail from China through North Korea and South Korea to further open the Chinese market and access North Korean ports.¹⁴⁷

Chinese firms are able to circumvent barriers to investment in North Korea by importing North Korean labor, which is not prohibited under UNSCR 2270, providing a major source of hard currency for the Kim regime. According to North Korean defectors, Pyongyang has steadily increased the number of workers it sends to China in recent years.¹⁴⁸ There are arrangements in Dandong and in Tumen—another Chinese city that borders North Korea—to allow North Korean laborers to cross the border for work.¹⁴⁹ According to Mr. Lee, at least 70,000–80,000 North Korean workers are employed in China as of August 2016, and “in a few years this [number] is likely to reach a few hundred thousand;” of the total workers in China, he assesses 30,000 North Koreans work in Dandong and 4,000 work in Tumen.¹⁵⁰ These workers are reportedly only allowed to keep one-third of their monthly wages; the rest must be sent to the Kim regime.¹⁵¹ The U.S. Department of State estimates North Korea receives compensation in the low hundreds of millions of dollars from work abroad, mostly in China and Russia.¹⁵²

Another critical area of support for the Kim regime is Chinese energy assistance to Pyongyang (aside from coal, mentioned earlier), and includes fuel, hydropower, solar panels, and power lines from China connecting into North Korea.¹⁵³ Among these, certain types of fuel are now sanctioned under UNSCR 2270, namely aviation fuel, including rocket fuel.¹⁵⁴ A North Korea economy expert told the Commission that electricity access in North Korea is now probably better than at any time since the famine in the 1990s, due in part to Chinese solar panel exports.¹⁵⁵ While the actual amount of Chinese fuel provided to North Korea is unknown (since China stopped reporting crude oil exports in 2014), evidence suggests it is rising, as more cars and trucks appear on the roads in Pyongyang and Chinese exports of automobiles and related components to North Korea over January–August 2016 have increased 29 per-

*The Guomenwan trade zone in Dandong opened in October 2015. The Ji'an Joint Border Economic Zone has been built but is not open, and the Helung Joint Border Economic Zone has yet to be constructed. Xinhua, “Largest City on China-North Korean Border Dandong Opens Border Trade Zone,” October 15, 2016. Staff translation. http://news.xinhuanet.com/world/2015-10/15/c_1116838250.htm; Lee Je-hun, “Report: N. Korea-China Relations Maybe Not So ‘Strained’ after All,” *Hankyoreh* (South Korea), November 13, 2015.

cent year-on-year.¹⁵⁶ An oil pipeline from Dandong to Sinuiju in North Korea has operated since 1976, and China has insisted that these exports support the “livelihood” of North Koreans under UNSCR 2270.¹⁵⁷ According to Yukihiro Hotta, a researcher at the Aichi University in Japan, the pipeline must maintain a minimum flow of 500,000 tons per year in order to avoid clogs that damage the pipeline.¹⁵⁸ China also has provided free oil to North Korea in the form of aid, which historically has not been included in its official exports.¹⁵⁹

China Continues to Prioritize Stability and the Status Quo

Despite Beijing’s frustration with North Korea’s belligerence and the increased threat its nuclear weapons and ballistic missile programs pose for China’s security interests, it still prioritizes stability and the status quo in North Korea to maintain a buffer between itself and U.S.-allied South Korea. According to a North Korea expert who spoke with the Commission, a major concern for China is that the collapse of the North Korean regime could inspire Chinese citizens to seek political reform or regime change in China as well.¹⁶⁰ Beijing is also worried a collapse scenario could cause an influx of North Korean refugees in northeast China.*¹⁶¹ A collapse could give rise to other problems for China, including unsecured nuclear weapons, the movement of U.S. forces closer to the Chinese border, or the outbreak of a major conflict that could drag China into war.¹⁶² As a result, Beijing holds stability in North Korea as a higher priority than denuclearization, though China has made efforts to prioritize denuclearization more recently, as noted earlier in this section.

Differences between China and the United States on North Korea Policy

As the North Korean threat to U.S. security interests grows, U.S. engagement with China on North Korea is of increased importance. However, China’s views of the U.S. role in the region pose obstacles to the productive engagement necessary to achieve the goal of denuclearization of the Korean Peninsula. Such views include the following:

- China perceives U.S. policy on North Korea is designed to strengthen U.S. alliances with South Korea and Japan, which it views are being leveraged to contain China.¹⁶³ Most recently, Beijing sees U.S. efforts to deploy THAAD in South Korea not only as a defensive measure taken to protect against potential North Korean missile strikes, but also as targeted at China. This, in China’s view, limits its own strategic offensive capabilities in a contingency.¹⁶⁴ As mentioned earlier, China sees the THAAD deployment in South Korea as complicating its strategic environment by expanding the U.S.-allied missile defense radar network in the region and facilitating closer intelligence sharing and broader strategic cooperation between the United States, South Korea, and Japan.

* Though instability in North Korea is often cited as a major concern for Beijing, some Chinese observers who met with the Commission in Beijing assert the resilience of the North Korean regime is understated and that no rebellion is on the horizon. Commission meeting with Chinese observers, Beijing, China, June 24, 2016.

- China advances the narrative that the United States incites Pyongyang to engage in provocations. In particular, Chinese officials and commentators refer to unilateral U.S. sanctions, high-profile U.S. military exercises with South Korea, and other actions as damaging to regional stability.*¹⁶⁵ In response to Secretary Carter's remarks following the September 2016 nuclear test that China take more responsibility for North Korea, China's Foreign Ministry spokesperson said, "Mr. Carter was being unnecessarily modest. The cause and crux of the Korean nuclear issue rest with the U.S. rather than China. The core of the issue is the conflict between the DPRK and the U.S. It is the U.S. who should reflect upon how the situation has become what it is today, and search for an effective solution. It is better for the doer to undo what he has done. The U.S. should shoulder its due responsibilities."¹⁶⁶

These views speak to fundamental differences in how China and the United States perceive developments in North Korea, necessarily limiting bilateral cooperation. At the heart of this mismatch in priorities is the debate about China's "leverage" over North Korea. U.S. officials and experts often refer to the leverage Beijing holds over Pyongyang by virtue of China's role as North Korea's primary source of economic and political support. They argue the North Korean "problem" can be solved if China uses its leverage to apply pressure on Pyongyang such that the regime will be forced to change its ways.¹⁶⁷ Though this may be true, to do so would undermine Beijing's ultimate goal: the maintenance of regime stability and the buffer state it perceives it needs between itself and the U.S.-allied South. Seoul-based scholar and long-time North Korea watcher Andrei Lankov explains China's perceived quandary:

From decades of experience China has learned that ... when the North Korean economy runs into trouble, it is the common people, not the small hereditary elite, who pay the price. And since commoners have no way to influence the government, the North Korean elite is always willing to pursue those policies most conducive to their interests, even if such policies mean economic hardships and starvation of the population at large. ... Hence, subtle pressures are not efficient in dealing with Pyongyang—and the Chinese know this very well. The only way to make a difference is to strike North Korea really hard, by dramatically reducing or halting nearly all economic exchanges, expelling North Korean workers, and taking other measures which will provoke a grave economic crisis in North Korea. Such a crisis might create a revolutionary situation, thus making the North Korean elite consider serious concessions on the nuclear and missile issues. However, such a hard blow is unlikely to ever be delivered by China. This is because extreme

*The Center for Strategic and International Studies' Beyond Parallel project studied North Korean provocations and U.S.-South Korea exercises from 2005 to 2016 and found that the exercises had a "null effect" on belligerent DPRK activity. Victor Cha, Na Young Lee, and Andy Lim, "Understanding the Relationship between DPRK Provocations and U.S.-ROK Military Exercises," *CSIS Beyond Parallel*. <http://beyondparallel.csis.org/dprk-provocations/>.

*pressure is more likely to bring about regime collapse than denuclearization, and regime collapse is not what Chinese leaders want to see.*¹⁶⁸

Implications for the United States

Unwilling to apply the full force of its leverage on Pyongyang, but unable to ignore U.S. and international appeals for cooperation on North Korea, Beijing pursues the status quo, doling out occasional punishments to the Kim regime. This necessarily leaves the United States and the international community hamstrung in encouraging change in North Korea. In addition, China's continued economic assistance to North Korea creates greater instability in Northeast Asia by facilitating the Kim regime's missile and nuclear weapons development. Beijing states that its goal is to realize a nuclear-free Korean Peninsula, but its actions suggest otherwise.

Indeed, Beijing's enabling of the Kim regime as a bulwark against U.S. and allied influence and power on the Korean Peninsula appears to be backfiring, as the United States, South Korea, and Japan pursue greater defense and intelligence cooperation and enhance their military capabilities against North Korea.¹⁶⁹ Following North Korea's September 2016 nuclear test, President Obama reiterated to Seoul and Tokyo "the unshakable U.S. commitment to take necessary steps to defend our allies in the region, including through the deployment of a [THAAD] battery to [South Korea], and the commitment to provide extended deterrence, guaranteed by the full spectrum of U.S. defense capabilities."¹⁷⁰ South Korea and Japan are increasingly concerned with North Korea's escalating threat. Tokyo has been exploring expanded missile defense capabilities for some time now, and North Korea's recent provocations appear to be lending these discussions more urgency.¹⁷¹

China's mistrust of the U.S.-South Korea alliance and its unique security priorities vis-à-vis North Korea restrict its level of engagement with South Korea and the United States in discussions about North Korea collapse scenarios and contingency planning.¹⁷² As a result, the countries most likely to intervene in North Korea in the event of regime collapse—the United States, China, and South Korea—are not fully informed of each other's intentions, which could lead to accidents, miscalculation, and conflict in the event of a contingency.

China's enforcement of UNSCR 2270 and its reaction to the THAAD deployment are still unfolding, while as of the publication of this Report, Beijing has stated that the next UN resolution following the September nuclear test should include tightened sanctions.¹⁷³ If the past is any indication, China can be expected to unevenly enforce UNSCR 2270 and the forthcoming round of sanctions in a way that will not seriously destabilize the Kim regime. The impact of THAAD is less clear, though in the near term it likely will encourage greater cooperation between Beijing and Pyongyang and cause increased tensions between China and the United States and South Korea.

Conclusions

- Following a series of missile and weapons systems tests demonstrating alarming advances in capabilities, in September 2016 North Korea conducted its fifth nuclear test, which was the most powerful to date. Beijing's diplomatic response to the test was its strongest yet, condemning the test and emphasizing that Pyongyang abide by UN resolutions. As of the publication of this Report, Beijing has said it will cooperate in a forthcoming UN resolution tightening sanctions on North Korea, but given its track record China can be expected to unevenly enforce sanctions in a way that will not seriously destabilize the Kim regime.
- Since 2012, when President Xi Jinping took office and Kim Jong-un became leader of North Korea, persistent North Korean belligerence has contributed to a noticeable downturn in China's relations with North Korea. This trend continued in 2016 when, after North Korea's fourth nuclear test, China supported the most stringent UN Security Council resolution to date on North Korea. Beijing appears to be attempting to maintain some stability in the relationship, but notably high-level exchanges (at the vice ministerial-level and above) between China and North Korea have decreased since the beginning of 2015 compared to the previous two-year period, continuing a negative trend from years prior.
- As North Korea increases the frequency of its missile tests, especially those using ballistic missile technology, and the UN Security Council and countries in Northeast Asia call for increased pressure on Pyongyang, Beijing continues to emphasize stability and the status quo above denuclearization as its guiding strategy regarding North Korea policy. Given its fear of instability in North Korea making its way into China and its desire to retain a strategic buffer between itself and U.S.-allied South Korea, Beijing will almost certainly not cut off trade of critical resources with Pyongyang, including coal and oil, or other sources of hard currency for North Korea.
- Although it is still too early to judge the full extent of China's enforcement of UN Security Council Resolution 2270, thus far Beijing has unevenly enforced sanctions and used to its advantage a significant loophole that allows China an exception to continue importing North Korean coal, iron, and iron ore for "livelihood purposes." While certain areas of progress and gaps are evident in Chinese enforcement thus far, China's lack of accountability and transparency in enforcing sanctions increases the difficulty for international observers to determine its level of enforcement.
- In accordance with the North Korea Sanctions and Policy Enhancement Act of 2016 (which became law in February 2016), the U.S. Department of the Treasury in September for the first time sanctioned Chinese entities with economic ties to North Korea, designating Dandong Hongxiang Industrial Development Co. and four Chinese nationals who directed and managed the firm for sanctions evasion activities and froze their assets. In addition, the U.S. Department of Justice indicted the individuals and enti-

ty for sanctions violations, conspiracy, and money laundering. It also confiscated funds in 25 Chinese bank accounts allegedly belonging to the firm and its front companies. These actions could compel Beijing to increase regulatory measures on Chinese firms doing business with North Korea, but such measures will probably be constrained by China's desire to support the Kim regime.

- China claims the decision by South Korea and the United States to deploy the U.S. Terminal High Altitude Area Defense (THAAD) ballistic missile defense system to South Korea to defend against North Korea's increased nuclear and missile capabilities is a direct threat complicating its own security environment. Beijing has used the announced deployment to obstruct international and regional cooperation on North Korea and to reduce certain areas of economic cooperation with South Korea. Over the near term, THAAD is likely to encourage China to move closer to North Korea, while increasing frictions between China, the United States, and South Korea.
- China's close economic ties with North Korea are unlikely to diminish significantly in the near term. In 2015, China accounted for approximately 91 percent of North Korea's legitimate foreign trade of \$6.25 billion (excluding trade with South Korea). One of North Korea's main sources of hard currency (which is not covered by sanctions) is from foreign labor, which generates revenue in the low hundreds of millions of dollars annually, mainly in China and Russia. According to an estimate in August 2016, approximately 70,000–80,000 North Korean workers are employed in China, and around 34,000 North Koreans work in two Chinese border cities, with this number set to rise in the coming years.
- As the North Korean threat increases, placing U.S. alliances and security interests at risk, China's skepticism about the U.S. role in the region poses obstacles to the productive engagement necessary to achieve the goal of denuclearization of the Korean Peninsula. Chief among these obstacles is Beijing's view that U.S. policy on North Korea is designed to strengthen U.S. alliances to contain China, and that U.S. military exercises with South Korea incite Pyongyang to conduct further provocations.

RECOMMENDATIONS

China and North Korea

The Commission recommends:

- Congress require the U.S. Department of State to produce an unclassified report assessing China's compliance with UN resolutions on North Korea.

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